

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PERU

COMPETITIVENESS REFORM PROGRAM

(PE-0239)

LOAN PROPOSAL

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BASIC SOCIOECONOMIC DATA

The basic socioeconomic data for Peru available on the Internet at the following address:

<http://www.iadb.org/RES/index.cfm?fuseaction=externallinks.countrydata>

INFORMATION AVAILABLE IN THE FILES OF RE3/FI3

PREPARATION:

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3. Recursos Humanos y Mercado Laboral Sector Educación. Informe Final preparado por el Instituto Apoyo, febrero, 2003
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15. Funcionamiento del Mercado de Servicios Arbitrales en el Perú: Diagnóstico y Propuestas. Informe Final preparado por el Instituto Apoyo, junio 2003.
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18. Propuesta de Lineamientos de la Estrategia Nacional de Competitividad del Peru. Informe Final preparado por J.E. Austin Ass.
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20. Apoyar en la Elaboración de la Matriz de Condicionalidad. Informe Final preparado por Apoyo Consultoría, setiembre 2003.
21. Propuesta de Lineamientos de la Estrategia Nacional de Competitividad del Perú-Fase I. Informe Final preparado por Centrum, Junio 2003.

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2. **Doing Business Database.** Private Sector Advisory Service, World Bank Group
<http://rru.worldbank.org/doingbusiness/default.aspx>
3. **Index of Economic Freedom 2003.** The Heritage Foundation. Edited by Gerald P. O'Driscoll, Jr. Edwin J. Feulner Mary Anastasia O'Grady.
<http://www.heritage.org/research/features/index/>
4. **Microeconomics of Competitiveness – Learning about Process** Michael E. Porter IDB November 18, 2002
5. Supplementary table on methodology for collecting data on outcome indicators

ABBREVIATIONS

ADRM	Alternative Dispute Resolution Mechanism
APN	National Ports Authority
CADE	Annual Conference of Executive (Conferencia Anual de Ejecutivos)
CAF	Andean Development Corporation (Corporación Andina de Fomento)
CNC	National Council of Science and Technology (Consejo Nacional de Ciencia y Tecnología)
CODESI	Multisectoral Commission for the Development of an Information Society (Comisión Multisectoral para el Desarrollo de la Sociedad de la Información)
CONCYTEC	National Council of Science and Technology (Consejo Nacional de Ciencia y Tecnología)
DBD	Doing Business Database (World Bank Private Sector Advisory Service)
DGAEICIP	International Economics, Competition and Private Investment Department (Dirección General de Asuntos de Economía Internacional, Competencia e Inversión Privada)
ENAPU	National Ports Enterprise (Empresa Nacional de Puertos)
FSRP II	Second Financial Sector Reform Program
FY	Fiscal Year
GCI	Growth Competitiveness Index
GCR	Global Competitiveness Report (of the World Economic Forum)
GDP	Gross Domestic Product
ICT	Information and Communications Technology (Tecnología de Información y Comunicaciones - TIC)
IFI	Financial Intermediary Institution (Institución Financiera Intermediaria)
IMF	International Monetary Fund
INDECOPI	National Institute for the Defense of Competition (Instituto Nacional de Defensa de la Competencia)
ISO	International Standards Organization
ISP	Upper-level Teaching Institute (Instituto Superior Pedagógico)
ISRP	Investment Sector Reform Program
IST	Upper-level Teaching Institute (Instituto Superior Tecnológico)
LSPN	National Port System Law (Ley del Sistema Portuario Nacional)
MEF	Ministry of Economy and Finance (Ministerio de Economía y Finanzas)
MICI	Microeconomic Competitiveness Index
NGO	Non-Governmental Organization
OC	Ordinary Capital (Capital Ordinario)
OSITRAN	Organismo Supervisor de la Inversión en Infraestructura de Transporte de Uso Público
PBL	Policy Based Loan
PCM	Presidency of the Council of Ministers (Presidencia del Consejo de Ministros)
PTI	Poverty Targeted Investment

R&D	Research and Development
RFP	Request for Proposals
SBS	Superintendency of Banks and Insurance (Superintendencia de Bancos y Seguros)
SIMTA	Information System for Monitoring Administrative Procedures (Sistema de Información y Monitoreo de Trámites Administrativos)
SUNAT	National Superintendency for Tax Administration (Superintendencia Nacional de Administración Tributaria)
TA	Technical Assistance
TC	Technical Cooperation
TSF	Technical Support Fund
UCPS	Sector Loan Coordinating Unit (Unidad de Coordinación de Préstamos Sectoriales)
USAID	United States Agency for International Development
USAID	United States Agency for International Development



PERU

IDB LOANS

APPROVED AS OF SEPTEMBER 30, 2003

	US\$Thousand	Percent
TOTAL APPROVED	6,303,682	
DISBURSED	5,393,777	85.56 %
UNDISBURSED BALANCE	909,905	14.43 %
CANCELATIONS	1,001,062	15.88 %
PRINCIPAL COLLECTED	2,367,457	37.55 %
APPROVED BY FUND		
ORDINARY CAPITAL	5,664,473	89.85 %
FUND FOR SPECIAL OPERATIONS	418,130	6.63 %
OTHER FUNDS	221,079	3.50 %
OUTSTANDING DEBT BALANCE	3,026,319	
ORDINARY CAPITAL	2,938,276	97.09 %
FUND FOR SPECIAL OPERATIONS	88,003	2.90 %
OTHER FUNDS	40	0.00 %
APPROVED BY SECTOR		
AGRICULTURE AND FISHERY	539,282	8.55 %
INDUSTRY, TOURISM, SCIENCE AND TECHNOLOGY	659,792	10.46 %
ENERGY	361,112	5.72 %
TRANSPORTATION AND COMMUNICATIONS	1,079,480	17.12 %
EDUCATION	196,577	3.11 %
HEALTH AND SANITATION	322,573	5.11 %
ENVIRONMENT	5,000	0.07 %
URBAN DEVELOPMENT	132,372	2.09 %
SOCIAL INVESTMENT AND MICROENTERPRISE	646,213	10.25 %
REFORM AND PUBLIC SECTOR MODERNIZATION	2,075,000	32.91 %
EXPORT FINANCING	176,756	2.80 %
PREINVESTMENT AND OTHER	109,525	1.73 %

* Net of cancellations with monetary adjustments and export financing loan collections.



PERU

STATUS OF LOANS IN EXECUTION AS OF SEPTEMBER 30, 2003

(Amount in US\$ thousands)

APPROVAL PERIOD	NUMBER OF PROYECTS	AMOUNT APPROVED*	AMOUNT DISBURSED	% DISBURSED
<u>REGULAR PROGRAM</u>				
Before 1997	1	100,000	89,466	89.47 %
1997 - 1998	5	577,100	287,969	49.90 %
1999 - 2000	4	132,408	24,312	18.36 %
2001 - 2002	7	561,300	223,501	39.82 %
2003	2	67,000	0	0.00 %
<u>PRIVATE SECTOR</u>				
2003	2	93,000	0	0.00 %
TOTAL	21	\$1,530,808	\$625,248	40.84 %

* Net of cancellations. Excludes export financing loans.



Peru

Tentative Lending Program

2003

Project Number	Project Name	IDB US\$ Millions	Status
PE0220	Institutional Support of the Congress	7.0	APPROVED
*PE0216	Grana y Montero ("G&M") Partial Credit Risk Guarantee	10.0	APPROVED
PE0218	Support to the Housing Sector Program	60.0	APPROVED
*PE0222	Camisea Project	75.0	APPROVED
*PE0235	Red Vial	18.0	APPROVED
PE0223	Strengthening and Modernization Tax System Administration	8.9	APPROVED
PE0187	Urban Transport in Lima	45.0	
PE0239	Competitiveness Reform Program	300.0	
Total - A : 8 Projects		523.9	
TOTAL 2003 : 8 Projects		523.9	

2004

Project Number	Project Name	IDB US\$ Millions	Status
PE0241	Youth Training Program	18.0	
PE0203	Science and Technology Program	25.0	
PE0251	Support Program for Forestry Concessions	2.0	
PE0234	Program of Support Services to the Rural Markets	15.0	
PE0142	Sanitation Sector Devel. Support Program II	50.0	
PE0240	Democratic Consolidation of Citizen Security	10.0	
PE1002	Moderniz of Controller Gral Office & Deconcent of National Control System	16.0	
PE0236	Support to Departmental Highway Decentralization	50.0	
PE0247	Reform of Poverty Alleviation Programs and Human Capital Development	300.0	
Total - A : 9 Projects		486.0	
PE0242	Public Transportation in Midium-Size Cities	40.0	
PE0250	Rural Financial Market Development	20.0	
PE0213	Urban Renewal of Downtown Lima	39.0	
Total - B : 3 Projects		99.0	
TOTAL - 2004 : 12 Projects		585.0	

Total Private Sector 2003 - 2004 103.0
Total Regular Program 2003 - 2004 1,005.9

* Private Sector Project

COMPETITIVENESS REFORM PROGRAM

(PE-0239)

EXECUTIVE SUMMARY

Borrower:	República del Perú			
Guarantor:	N/A			
Executing agency:	Ministerio de Economía y Finanzas			
Amount and source:	IDB: (OC)	US\$	300,000,000	
	Local:	US\$	0	
	Total:	US\$	300,000,000	
Financial terms and conditions:	Amortization Period:	20	Years	
	Grace Period:	5.5	Years	
	Disbursement Period: Minimum	18 months from date of contract effectiveness		
	Maximum	3	Years	
	Interest Rate:	Libor ¹		
	Supervision and Inspection:	1.00	%	
	Credit Fee:	0.75	%	
	Currency:	US Dollars under the single currency facility		
Objectives:	<p>The overall objective of this Program is to improve the competitive position of Peru and ultimately to raise the living standards of its population. Under the aegis of the National Competitiveness Council (CNC), the program will establish a more stable and lasting institutional framework for carrying out the public-private collaboration that is essential to overcoming impediments to sustained productivity growth in Peru. Such collaboration at the sector and local levels will be fostered by promoting productive associations (<i>clusters</i>) and by implementing policy reforms identified at the public-private National Competitiveness Forum held in February 2003.</p>			
Description:	<p>The Program initiatives are divided into three broad and complementary areas. The first will help to establish a more reliable and long-term approach to addressing and resolving impediments to competitiveness by strengthening the CNC and other institutions directly involved in the public-private harmonization process. The second area consists of two distinct aspects of policy and institu-</p>			

¹ May be changed to a variable rate prior to first disbursement in accordance with Bank policies.

tional reform. One of these will help to improve the climate for private sector investment, thereby improving the chances for success of specific initiatives identified by CNC and its working groups, while the other will address specific impediments to improved efficiency and cost reduction at the enterprise level. The third area will improve specific public-private cooperation activities at the local level through the development of *clusters*².

Coordination with other Multilateral Development Institutions

The program is well coordinated with related initiatives sponsored by USAID, the World Bank, and the CAF. As noted in Chapter I, the policy orientation of the PBL usefully complements the technical assistance focus of these other programs. (Paragraphs 1.26 – 1.28)

Bank's country and sector strategy:

The broad objective of the Bank's country strategy is the sustained and sustainable reduction in poverty. The specific objectives of the strategy are to (a) raise the economy's productivity and competitiveness; (b) improve the efficiency of social policy, and (c) create a modern and efficient state at the service of the population. The proposed program will directly help to achieve the first of these objectives. Several of the concrete policy initiatives laid out in the country strategy paper are consistent with and provide support for the reforms to be implemented by the proposed program.

The program is consistent with the Bank's competitiveness (sector) strategy which encourages a continuing public-private dialogue and calls for initiatives in the following priority action areas: (a) efficient mobilization of financial and capital resources; (b) improvement and higher productivity of human resources; (c) efficient provision of infrastructure services; (d) development and assimilation of new knowledge and technologies; (e) more effective support institutions for private productive activities; and (f) competitiveness and the productive and sustainable management of natural capital. The program contains components, which address the first five of these priority action areas directly and the sixth one indirectly.

Environmental/social review:

The program will have no direct environmental impact because the initiatives are limited to legal, regulatory and institutional reforms. In those cases where there are indirect impacts, the necessary provisions have been included in the design of the reform measures, per the instructions of the CESI meeting on May 2, 2003

² In this document *cluster* is a generic term for productive associations, production chains, or similar groupings which "...reflect the fundamental influence of externalities/linkages across firms and associated institutions in competition" (Porter 2002)

Benefits:

The program is intended to lessen or remove specific impediments to productivity growth as well as to improve the framework for achieving a public-private cooperation on raising national competitiveness. At the policy and institutional reform level the program will (i) support institutionalization of the competitiveness process through strengthening the CNC and the associated public-private consultative groups; (ii) streamline judicial and extra-judicial resolution of commercial disputes; (iii) reduce bureaucratic procedures required for the formation, operation, and closure of businesses; (iv) improve the policy environment for private investment in transport and other public services; (v) promote clear rules and operating procedures for privately owned port facilities; (vi) reduce the uncertainty associated with granting credit thereby increasing its availability; (vii) increase the quality and transparency of worker training programs and the competency of their graduates; (viii) improve efficiency of scarce public funds spent on science and technology; and (ix) increase the use of information and communications technology. The program will also promote public-private cooperation in developing *clusters* at the local level.

Risks:

A general issue, which affects this program, is the uncertain political will and ability to carry out reforms in Peru. Given the composition of Congress and the power of various interest groups it is difficult to be assured that reforms will either be approved as proposed or implemented as approved. The initiatives in the program have been designed to be feasible within this context by being either confined to those within the power of the executive branch or, in those few cases which require action by other branches of government, by building on broadly supported reforms that are well underway.

The single most important specific risk to the program within this general framework is failure of the CNC to operate as a credible and widely respected forum for public-private dialogue on competitiveness with a consequent inability to promote and coordinate the national competitiveness agenda. As currently formulated the CNC, is an internal advisory body of the PCM, heavily weighted toward public-sector representation with virtually no autonomy for selecting its private sector members nor its executive director. Furthermore the executive director has little authority over the staff assigned to work as technical secretariat to the CNC, as they are part of the PCM. As a condition for first tranche release, the CNC statutes will be modified to enable the private sector (business and

labor) to nominate their representatives independently for staggered four-year terms and be removed only for specific cause. The role of Executive Director and Technical Secretary will be merged, and the CNC board will be able to designate this individual who will direct the activities of the support staff (see Chapter II). These reforms will provide greater independence to the CNC.

A second risk to the program is the possibility that the autonomous Supreme Court may not implement the specialized commercial court judgeships and/or raise the court fees to self-sustaining levels. However the former proposal has been approved by the full Supreme Court, and detailed planning for implementation is underway. The latter proposal is actively under study. These advances as well as the related technical assistance provide reasonable assurance that the reforms will be carried forward.

The executing agency's inadequate coordination of program implementation represents a third risk. To ameliorate this risk the MEF is strengthening its program implementation unit and will sign letters of understanding with each of the line agencies ("sub-executors") detailing the responsibilities of each and specifying conflict resolution procedures.

Special contractual clauses:

The program will be carried out pursuant to the terms and conditions stipulated in the loan contract. The policy-based contractual clauses are summarized in Annex I.

Poverty-targeting and social equity classification:

This operation does not qualify as a social equity-enhancing project, as described in the indicative targets mandated by the Bank's Eighth Replenishment (document AB-1704). Furthermore, this operation does not qualify as poverty targeted investment (PTI).

Exceptions to Bank policy:

None.

Procurement:

As a PBL, this operation does not contemplate the procurement of goods and services. The GOP has requested that consultancy services under the related TA component be obtained according to standard Annex C procedures.

I. FRAME OF REFERENCE

A. Introduction

- 1.1 The government of Peru has requested a Policy Based Loan (PBL) from the Bank in support of a program to improve the country's competitiveness. The program is described in the following chapters of the report. In order to put the program in context, this chapter provides some background on Peru's relative competitive position and the current macro-economic situation in the country.
- 1.2 The January 2003 Bank Strategy Document on competitiveness summarizes the concept as "...the quality of the economic and institutional environment for the sustainable development of private productive activities and the increase in productivity." A sound macroeconomic, political, legal and social context is necessary but not sufficient for productivity increases. The microeconomic foundations must also be in place, which in turn rest on (1) the sophistication with which domestic companies or local subsidiaries of foreign companies compete, and (2) the quality of the microeconomic business environment. This operation is intended to contribute to improving this environment, thereby assisting firms in Peru and ultimately the country as a whole to become more competitive.
- 1.3 Each year the World Economic Forum publishes a ranking of a worldwide sample of countries in terms of their "growth competitiveness index" (GCI) and their "microeconomic competitiveness index" (MICI).³ In 2002 Peru ranked 54th out of 80 countries (68th percentile) world wide in the overall GCI rankings. This places it at the top of the bottom third of all countries, but ahead of all other Andean countries⁴. This 2002 ranking represents a mild deterioration compared to the 2001 score in which Peru placed 55th out of 75 countries (73rd percentile). At the micro-economic level, Peru was 66th out of 80 countries in the 2002 MICI rankings, while it was 63rd out of 75 in 2001 (placing it in the 83rd and 84th percentiles respectively). Peru placed ahead of Bolivia, Ecuador and Venezuela but behind Colombia at the micro-economic level.
- 1.4 These low rankings can be put into historical context by noting that for the last 30 years real per capita income in Peru has essentially stagnated at around \$2,400 (in constant 1995 dollars), and although the GCI and MICI were not published 30 years ago, Peru's relative position would have almost certainly been higher in the early 1970s than it is today. Just in terms of real per capita income, Peru ranked in

³ The GCI is a weighted average of indicators measuring each country's relative position in three broad areas found to drive economic growth in the medium- and long-term, namely: technology, public institutions, and macroeconomic environment. The MICI is a weighted average of two sub indices measuring the quality of national business environment and the sophistication of company operations and strategy, which in turn are made up of a large number of hard data and survey information for each country.

⁴ World Economic Forum *Global Competitiveness Report (GCR) 2002-2003*. The 2002 rankings of the other Andean countries are as follows: Bolivia (78th), Ecuador (73rd), Venezuela (68th), and Colombia (56th).

the 55th percentile of all countries in 1971, while it had dropped to the 67th percentile by 2000.⁵ During the same period total factor productivity declined somewhat in the 1970s followed by substantial erosion in the 1980s, and a mild recovery in the 1990s, as follows⁶:

<u>Period</u>	<u>Annual Average Growth in Total Factor Productivity</u>
1971 – 1980	-0.94 %
1981 – 1990	-3.66 %
1990 – 1999	0.91 %

B. The macro-economic context

- 1.5 In the midst of the pervasive contractionary climate in Latin American and Caribbean region, Peru was the best macroeconomic performer in 2002. After four years of sluggish overall growth and outright investment recession, the Peruvian economy posted a GDP growth rate of 5.2 percent, the highest in Latin America. And this was accomplished in a context of considerable macroeconomic stability. At 1.52 percent, the annual rate of inflation was the third lowest in the region. Furthermore, the currency has been remarkably stable and the external sector is close to an equilibrium situation.
- 1.6 The growth rate of real GDP is expected to be 4 percent in 2003. Growth is expected to continue in 2004-2005 at rates in the neighborhood of 4.5-5.0 percent. Nonetheless, the Peruvian economy is vulnerable, particularly to fiscal imbalance. After a period of virtual equilibrium in 1996-1998, when the average fiscal deficit was just 0.6 percent of GDP, the fiscal gap grew to an average of 2.9 percent of GDP in 1999-2001. Fiscal adjustment began in 2002 and the deficit was reduced to 2.3 percent of GDP. The tax system is a major source of this fragility, as it was allowed to deteriorate in the second half of the nineties. Progress in fiscal adjustment in 2002 was possible thanks to administrative measures taken by the tax agency (SUNAT) supported by Bank sector reform and technical cooperation operations. Tax collection grew by about US\$200 million (0.35 percent of GDP)
- 1.7 ***Stand-By Agreement with the IMF.*** On March 28, 2003, The Executive Board of Directors of the International Monetary Fund (IMF) completed the second review of Peru's performance under a two-year SDR 255 million (about US\$347 million) Stand-By Arrangement, approved on February 1, 2002. The authorities' economic program for 2003 aims at supporting the recovery in economic activity while keeping inflation low. Real GDP is projected to grow by 4 percent, with inflation around 2 ½ percent and the external position remaining robust. The fiscal deficit is targeted to decline moderately to 1.9 percent, in line with the authorities' medium-term fiscal consolidation goals. Under the program with the IMF, the struc-

⁵ Ranking of countries by per capita income. In 1971 Peru ranked 36th out of 65 countries. In 2000 it ranked 53rd out of 79 countries. Source: World Bank *World Development Indicators*.

⁶ Carranza et al as cited in A. Melo *La Competitividad del Perú Después de la Década de Reformas: Diagnóstico y Propuestas* IDB (p. 37).

tural reform agenda for 2003 includes introducing a sound fiscal decentralization law; beginning to phase out regional and sectoral tax exemptions in exchange for investment in regional infrastructure; and strengthening the law on fiscal prudence and transparency. The authorities also intend to rationalize public expenditure and improve the quality of social spending, with the assistance of the Bank and the World Bank.

C. Broad reasons for Peru's relative competitiveness position⁷

- 1.8 While the current macro-economic situation and trends play an important role in enabling or limiting a country's potential for productivity growth, a favorable micro-economic environment is essential to competitive behavior at the level of individual businesses. The following table contains the percentile ranking of Peru and the three other Andean countries for several micro-economic indicators directly relevant to the program. Because countries are ranked from 1 (best performer) to 80 (worst performer) a higher percentile value signifies a lower performance level. As can be seen, Peru and its comparator countries fall in the bottom third of all countries, although Peru compares favorably with Bolivia and Ecuador on most indicators while lagging behind Colombia on most.

Selected Microeconomic Indicators of Peru Relative Competitive Position in 2002⁸
(Percentile ranking)

	Perú	Bolivia	Colombia	Ecuador
Financial System and Capital Markets				
Access to credit	69	90	30	94
Infrastructure and Regulation of Roads, Ports and Airports				
Overall Infrastructure Quality	84	99	81	91
Port Infrastructure Quality	84	100	86	73
Human Resources and Labor Market				
Extent of Staff training	74	94	60	96
Informal sector	94	99	70	71
Enterprise development and productive chains				
Value chain presence (Domestic value added)	90	91	58	96
Technological Innovation				
Quality of scientific and research institutions	86	93	71	94
Public Institutions, contracts and Law				
Judicial Independence	86	95	65	98
Efficiency of Legal Framework for Private Businesses to settle disputes	76	90	64	98

- 1.9 Several factors contribute to Peru's low levels of micro-economic competitiveness. Important among these is the judicial system. The reliable, impartial, and expedient administration of justice, particularly as regards enforcement of contracts and resolution of commercial disputes is critical to a favorable business en-

⁷ The following discussion is drawn from Eduardo Lora, *La Posición Competitiva del Perú*, presentation to the Conferencia Anual de Ejecutivos (CADE) 2002, Lima and A. Melo *La Competitividad del Perú Después de la Década de Reformas: Diagnóstico y Propuestas* IDB, 2003

⁸ Source: *Global Competitiveness Report* 2002-2003

vironment. Yet in Peru the administration of justice is deficient with the result that respect for the law is way below the world average and ranks 11th out of 20 Latin American countries. Meanwhile Peru ranks lowest in the continent in terms of trust in the judicial system with more than 80% of the respondents in a 2001 survey indicating little or no confidence in the judiciary.

- 1.10 Regarding bureaucratic procedures directly impacting on the cost of doing business, surveys show that Peru ranks worst of all major Latin American countries in terms of the number of days needed to establish a new business. This has contributed to the country having highest proportion of labor force in self-employed or micro-business activities.
- 1.11 In the area of infrastructure services, Peru ranks second behind Bolivia in value of infrastructure facilities privatized as percentage of GDP since 1988. However investment in infrastructure has been among the lowest in Latin America. Electricity generation is only about 60 percent of the level to be expected given Peru's income level. Port facilities and the transshipping services they provide are poor both absolutely and relative to other countries with comparable per capita income levels. Fiscal austerity measures have limited public investment in infrastructure and private investment has been discouraged by a number of factors, including the lack of a policy framework and recent public opposition to the participation of the private sector in the modernization of infrastructure services.
- 1.12 Access to financial services has improved substantially over the last decade but still remains low. Several important reforms in the 1990s raised credit as proportion of GDP from 5% in 1991 to around 25% in 2000, but this is still substantially below other Andean countries (Bolivia and Ecuador are both above 60%, while Colombia is close to 40%). An important reason for this is the difficulties lenders have recovering on bad loans. Lenders' rights are weak and poorly protected.
- 1.13 Deficiencies in Peru's labor force also contribute to its poor competitiveness scores. While the country provides a reasonable quantity of schooling, its quality and relevance to necessary job skills is seriously deficient. This results in reduced productivity and low salaries even for university educated workers. Once on the job Peruvian workers receive little training, due limited incentives for its provision, poor training facilities, and high degree of informality in labor force.
- 1.14 In the area of science and technology Peru's system is fragmented, lacks resources, and does not act as a catalyst for productive development. In addition, spending on research and development during the last decade has been about 0.1% of GDP, significantly below the Latin American average and far from the developed countries investment on R&D. Peru lags behind the regional average in indicators such as patents, international publications, graduate and doctoral students, and nearly all investments in science and technology funds are channeled through public institutional budgets, to different public institutes, technology transfer centers, and universities.

- 1.15 As described below, the likely causes of these deficiencies were the subject of extensive analyses carried out by working groups made up of public and private sector members. The findings of these groups have been incorporated into the proposals supported by this program.

D. Initiatives to date to improve Peru's competitiveness

- 1.16 Peru is in the early stages of a transition toward a more collaborative approach to relations between the public and private sectors. Only recently has it formally initiated a competitiveness agenda, and much remains to be done before a fully collaborative approach is understood much less wholeheartedly adopted by leaders in the government, private sector, and civil-society communities.

1. Institutionalization of the competitiveness process

- 1.17 Understanding and more importantly embracing the concept of competitiveness remains a major challenge in Peru today. Initial public discussions of the topic took place at the Annual Conference of Executives (*CADE*) in Lima in November 2001, and in April 2002 the President of the Council of Ministers created the National Competitiveness Council (*Consejo Nacional de Competitividad – CNC*) as a coordinating commission reporting to the cabinet-level Presidency of the Council of Ministers.
- 1.18 At the same time a major national initiative was underway to develop a broad consensus on guidelines for the future direction of the country, and in July 2002 representatives of the major political parties and civil society signed the “National Accord” (*Acuerdo Nacional*) consisting of 29 principles designed to provide a framework for the formulation of national policy for the next 20 years. These principles are grouped under four main objectives, which are (i) democracy and the rule of law; (ii) equity and social justice; (iii) national competitiveness; and (iv) an efficient, transparent and decentralized state. Thus the formal framework for undertaking a national competitiveness agenda was established.
- 1.19 In February 2003 the CNC, with Bank support, sponsored a “National Forum on Competitiveness” (*Foro Nacional de Competitividad*), which brought together representatives from the public, private, academic, and labor sectors as well as other members of the civil society and the international development institutions. The purpose of the Forum was to establish the guidelines for a National Competitiveness Strategy for Peru based on the analyses carried out by nine thematic working groups⁹. The Forum reactivated the national dialogue on competitiveness

⁹ The nine thematic areas represent the main problem areas identified by the MICI and previous general diagnostic studies carried out by the Bank and other IFIs. The areas so identified are (i) financial system and capital markets; (ii) foreign trade and investment; (iii) infrastructure and regulation of roads, ports and airports; (iv) human resources and labor market; (v) education; (vi) enterprise development and production chains; (vii) technological innovation; (viii) institutional issues, intellectual property, transactions costs, legal processes, and consistency of public policies; and (ix) competitiveness and regional de-

issues and set the stage for the preparation of the National Competitiveness Strategy. The next step, which is currently underway, is to integrate the reports presented at the Forum into an overall Strategy.

2. The PBL as one component of the broader National Competitiveness Strategy

- 1.20 Some issues identified in the working-group reports clearly deserve immediate attention and require legal, regulatory, or institutional reforms in order to further the objectives of the strategy. These issues are amenable to treatment within the context of a PBL given its focus on policy reforms. The issues so identified do not have a one-to-one correspondence with the original nine thematic areas but instead represent a sub-set, and in some cases a combination, of the areas analyzed by the thematic working groups; however they form part of the general competitiveness strategy currently under discussion in Peru, and represent areas in which the authorities recognize the importance of moving expeditiously to make improvements. As described below these issues form the core conditions in the policy matrix and are also incorporated in the policy letter.

E. Bank strategy and rationale for involvement

- 1.21 **The Bank's country strategy** has the broad objective of sustained and sustainable reduction in poverty. The specific objectives of the strategy are to (a) raise the economy's productivity and competitiveness; (b) improve the efficiency of social policy; and (c) create a modern and efficient state at the service of the population. In order to achieve the first objective the country strategy calls for giving the highest priority to macroeconomic stability and fiscal sustainability, improving human capital (education, training, and local development of science and technology), and assuring the effective application of regulations that establish a stable and efficient environment for the allocation of human and financial resources. The proposed competitiveness sector program will directly help to achieve the first of these objectives. By the same token several of the concrete policy initiatives laid out in the country strategy paper are consistent with and provide support for the reforms to be implemented by the proposed program.
- 1.22 **The Bank's Competitiveness Strategy Document** of January 10, 2003 encourages a continuing public-private dialogue and calls for initiatives in the following priority action areas: (a) efficient mobilization of financial and capital resources; (b) improvement and higher productivity of human resources; (c) efficient provision of infrastructure services; (d) development and assimilation of new knowledge and technologies; (e) more effective support institutions for private productive activities; and (f) competitiveness and the productive and sustainable management of natural capital. As will be discussed in the next chapter the program

contains components, which address the first five of these priority action areas directly and the sixth one indirectly.

F. Previous Bank support for sector reform and lessons learned

- 1.23 The Bank has supported reform in several of the areas addressed by the proposed Competitiveness Reform Program. The Investment Sector Reform Program – ISRP (Lo. 985/OC-PE), approved in 1996, included proposals to reform and strengthen the regulatory framework for (i) infrastructure concessions and (ii) the financial system. The program also called for the concessioning of highways and ports. While the measures to improve the financial system regulatory framework were largely implemented, the establishment of a framework for regulating privatized infrastructure services, and of ports in particular, was unsuccessful and the borrower was unable to concession the ports as required. For this and related reasons the second tranche of this operation was cancelled. This experience clearly demonstrates the importance of having a broad consensus for establishing a regulatory and institutional framework before attempting to let concessions of infrastructure services to private operators. The proposed operation applies this lesson by building on the new *Ley de Sistema Portuario Nacional* and requiring the approval of implementing regulations and the establishment of a National Ports Authority (APN).
- 1.24 In the finance area, the ISRP among other measures called for the administrative and budgetary autonomy of the Superintendency of Banks and Insurance (SBS). This measure was not satisfactorily implemented and became the subject of the subsequent second Financial Sector Reform Program – FSRP II (Lo. 1195/OC-PE) approved in 1999¹⁰, thus demonstrating the importance of follow-up on key issues. The FSRP II operation also included a provision for the action plan to implement moveable property guarantees. This action plan was not fully realized during the execution of the FSRP II but it did lay the groundwork for the MEF commission that has drafted the law, which is to be presented to Congress as a condition for first tranche release of the proposed operation. The lesson from these cases is that policy reform is an ongoing process and that continued attention to key areas may be needed over several operations. As indicated in the next chapter, these lessons are being applied in the present operation.

G. Complementary programs of the Bank and other international agencies

- 1.25 **The Bank** has several operations in preparation or execution, which complement the proposed competitiveness program. These include (i) the Fiscal Reform Program (PE-0211) in support of greater neutrality and equity in the tax system and reduction in labor surcharges; (ii) Modernization of Tax administration (PE-0223) to improve tax and customs administration and reduce the “*trámites*” for taxpayers; (iii) Modernization and Decentralization of the State (PE-0217) to improve and make more transparent government services, among several other initiatives;

¹⁰ The first Financial Sector Reform Program was approved in 1992 and was fully disbursed in 1994.

- (iv) the Science and Technology Program (PE-0203) to improve the country's research and technological innovation capacity; (v) the Youth Labor Training Program (PE-0241) to improve the employability of underprivileged young adults; and (vi) the Foreign Trade Policy Development Program (PE-0219) designed to improve the management of foreign trade policy.
- 1.26 **The World Bank** approved in May 2003 a US\$24 million program (\$20 million loan) for "Trade Facilitation and Productivity Improvement Technical Assistance". The program will be executed by the Presidency of the Council of Ministers (PCM) and will provide TC support to fifteen agencies throughout the Peruvian government for specific export-related initiatives, which will complement the broader and more policy oriented focus of the proposed program. The World Bank is also preparing a series of multi-sector programmatic adjustment loans, which will include a component on competitiveness.
- 1.27 **The United States Agency for International Development (USAID)** has approved grants for two related technical assistance programs. The first program (approximately US\$11 million) supports reform in three areas: (i) improved legal and institutional framework; (ii) improved trade framework; and (iii) improved infrastructure development & regulations. The specific initiative to be undertaken in each of these areas has not been defined yet, and USAID will take care not to duplicate the Bank's program. The second USAID program is a US\$20 million technical assistance grant for Modernizing the Justice Sector, which will support reforms of (i) general aspects of the judiciary and criminal system; and (ii) the commercial system. USAID expects to allocate approximately \$3 million for training, IT, and facilities for the new commercial court justices in metropolitan Lima. This will be coordinated with the related TA activities of the PBL (See Chapter III).
- 1.28 **The Andean Development Corporation (CAF)** is expected to approve in late 2003 a hybrid operation to be funded with a US\$228 million loan which will support initiatives in three areas: (i) social investment; (ii) governance; and (iii) competitiveness. The social investment component includes funding for general budget support (\$70 million) and specific investment projects (\$143 million), while in the governance component provides \$10 million in counterpart funding for the Bank's "State Modernization and Decentralization Program" (PE-0217). The competitiveness component will provide \$5 million for funding TA activities associated with implementation of the government's competitiveness strategy, including \$3 million for the MEF in support of the Competitiveness Reform Program (see Chapter III), and \$2 million for the PCM, which will provide counterpart funding for the World Bank's TC program described above.

II. OBJECTIVES AND DESCRIPTION OF THE PROGRAM

- 2.1 **The overall objective** of the Competitiveness Reform Program is to improve the competitive position of Peru and ultimately to raise the living standards of its population. The program focuses on improving the productivity of the country's businesses by establishing a more stable and lasting institutional framework for carrying out the public-private collaboration essential to overcoming impediments to sustained productivity growth in Peru. The centerpiece of this institutional framework is the CNC, which in turn will involve public-private working groups to develop action plans in several areas, particularly the promotion and facilitation of clusters at the local level. The Program will further contribute to this process by implementing several of the policy-oriented and institutional reforms, which were identified by the public-private consensus achieved at the National Competitiveness Forum held in February 2003.
- 2.2 The Program initiatives are divided into three broad and complementary areas. The first, discussed in section A below, will help to establish a more reliable and long-term approach to addressing and resolving impediments to competitiveness by strengthening the CNC and other institutions directly involved in the public-private harmonization process. The second area, discussed in sections B and C below, will respectively (i) help to improve the climate for private sector investment, thereby improving the chances for success of specific initiatives identified by CNC and its working groups; and (ii) address specific policy and institutional impediments to improved efficiency and cost reduction at the enterprise level. The third area, discussed in section D below, will improve specific public-private cooperation activities at the local level through the development of productive associations (*clusters*). The policy and institutional reforms supported by the PBL are far from an exhaustive list of possible reforms and in fact could be better characterized as the beginning of a multi-decade reform agenda. The specific measures to be supported by the PBL are indicated in the policy matrix (Annex I) and are described in the following paragraphs. The effectiveness of the program in terms of its "outcome" is discussed in Chapter III and the results of the policy initiative along with their measurement indicators is presented in Annex II.

A. Institutionalization of the competitiveness process

- 2.3 **Background.** The National Competitiveness Council (CNC) was created in April 2002¹¹ with the functions of promoting a competitiveness culture, coordination, formulation and agreement on national competitiveness strategies for presentation to the executive branch. These strategies are then implemented by the corresponding sectoral agencies of the executive branch and private sector associations. At the present time the CNC is composed of eight ministers of state, the president of INDECOPI, three representatives of the private sector, and one labor representative and the executive director. A (private-sector) representative of small and mi-

11 Supreme Decree DS: 24-2002-PCM. Regulations were issued in July 2002 (Ministerial Resolution 262-2002-PCM) which were further modified in October (DS: 100-2002-PCM)

cro business will be added, and a founding private-sector member whose term expired has been named as an honorary member, with a voice but no vote. Importantly, the CNC is chaired by the President of the Council of Ministers (Prime Minister) and structurally is an internal advisory body of the Ministry. The private sector and labor representatives and the executive director are nominated by the Prime Minister and formally appointed by the President of the country by means of a Supreme Resolution. At present the private sector has no independent voice in selecting its members.

- 2.4 **Objective and justification.** The institutional framework to implement the National Competitiveness Strategy should promote an efficient synergy between public, productivity-enhancing policies and private, firm-level competitiveness initiatives. The construction of such a national system of competitiveness is a complex and long-term endeavor that is intimately related to the reform and modernization of the state. Nonetheless one element that will notably contribute to promoting this process is the existence of a stable and independent CNC that provides an arena for public-private cooperation in the design and coordination of public policies intended to improve productivity and competitiveness.
- 2.5 Without independence and stability, the CNC will not be credible to the private sector, including the business community and other non-government sectors of civil society. In turn, without credibility, the CNC will not be able to carry out its function as a forum for public-private collaboration on competitiveness issues. A stable and independent CNC will also provide the framework for advising and monitoring reforms that are multi-sectoral in scope and encompass diverse areas based on a shared vision of national and regional development. Meanwhile responsibility for implementing these policies resides with the corresponding public agencies, which also form part of the National Competitiveness System.
- 2.6 **Program Initiatives.** For first tranche the borrower will issue a supreme decree modifying the statutes that govern the CNC in order to establish a process for selecting the private-sector directors on the CNC that assures their credibility, representivity, and independence. The precise process will be determined by the private sector itself, however it will assure that the selected individuals have broad knowledge of and experience with business and labor issues. They will not represent particular business associations or labor unions, although they could be selected from these groups. The private sector members will serve staggered four-year terms and may be removed only for pre-specified cause. All members of the CNC will nominate the Technical Secretary. The private sector members and the Technical Secretary will be formally appointed by means of a supreme decree of the President of Peru. The modifications to the CNC statutes will also provide for the creation of public-private consultative groups (discussed below). The Technical Secretary will manage a small group of full-time professionals who will provide analytical and technical support to the CNC and to the thematic consultative groups. The functioning of the CNC will be evaluated one year after first disbursement according to criteria based on its governing statutes as agreed with the Bank. The results of the evaluation will be taken into account prior to second

tranche. In addition for first tranche, the existing CNC will agree on the National Competitiveness Strategy and its agenda for implementation. The Strategy will be formally approved and published by the Council of Ministers, and thereby become official Government policy. The Strategy, heavily influenced by private sector concerns, is subject to adjustments in light of evolving trends.

- 2.7 As noted, the CNC will have the authority to create public-private consultative groups that will prepare studies and provide input to the CNC in their respective areas of expertise. These groups will include public officials and private sector members from related interest groups, and will be chaired preferably by the appropriate vice-minister in the corresponding line ministry. While the CNC may autonomously determine the subject matter, timing, and specific composition of each group, the Letter of Sector Policy commits the executive branch members of the CNC to propose creation of consultative groups in the priority areas identified during the National Competitiveness Forum in February 2003. Among others, these are: technological innovation, information and communications technology, transportation, clusters, intellectual property rights, competition, and foreign trade. These groups will represent and collaborate closely with the public agencies and private associations that have a direct interest in the respective areas. They will serve as a forum and sounding board for vetting new ideas.
- 2.8 By second tranche, the CNC will be in full operation according to its revised operating guidelines and will be acting upon the reports and recommendations from the consultative working groups. The evaluation of the CNC will have been completed, presented to the government and Bank, and any deficiencies found by the evaluation will either be corrected or corrective measure will be put in place. The Technical Secretariat will be operating a system for monitoring and evaluating the National Competitiveness Strategy and the progress being made in implementing its agenda, as well as for resolving problems as they arise.

B. Environment for private investment

- 2.9 The role of government in economic development is to "...establish a stable and predictable macroeconomic, legal and political environment, including privatization and market opening. [This includes improving] ...the availability, quality and efficiency of general purpose inputs, infrastructure and institutions and setting the overall rules and incentives governing competition that encourage productivity growth"¹² The following paragraphs describe several important features of the climate for private sector investment in Peru and the steps proposed for improvement.¹³

¹² Porter "Microeconomics of Competitiveness – Learnings about Process" slides presentation at IADB Nov. 2002.

¹³ In addition to the initiatives proposed in the following paragraphs, the government has committed in the Policy Letter to continue its foreign trade strategy for reducing the dispersion and average level of tariffs.

1. Macro-economic stability

- 2.10 **Objective and justification.** A necessary but not sufficient condition for businesses in a country to become more competitive is a stable macroeconomic environment. Thus the standard macro-economic condition of all Policy Based Loans is particularly relevant to this Competitiveness Sector Program, and is considered as a condition directly bearing on the environment for private sector investment rather than separately, as is normally done in sector loans.
- 2.11 **Program Initiatives.** The macroeconomic policy framework needs to be consistent with the objectives of the program, which is to say that this framework has to assure fiscal sustainability, a low and predictable inflation rate, and a reasonably stable exchange rate. Adherence to these norms will be determined at the time of first tranche release by assessing Peru's compliance with the targets of the Government's Multi-annual Macroeconomic Framework (*Marco Macroeconómico Multianual* – MMM). The Bank will also monitor compliance with the targets of the IMF Standby Arrangement currently in place. The same procedure will be followed for the second tranche.¹⁴

2. Conflict resolution and bureaucratic procedures

a) Creation of Commercial Courts

- 2.12 **Background.** The Peruvian Judicial System is made up four types of courts: civil, labor, family, and criminal courts. Each one of them depends on a Superior Court, which is dependent on the Supreme Court. Other Latin American countries have a specialized commercial court to receive business-related disputes; however in Peru, the 61 civil courts are responsible for all these cases, as well as for many other related cases. A recent study¹⁵ showed that in Lima, between January and April 2001, 65% of the various legal proceedings under consideration by the civil courts were commercial cases.
- 2.13 The lack of commercial courts has caused some structural problems that affect the performance of companies in Peru. Some of these problems are: (i) the inappropriate training of sitting civil judges to deal with commercial cases; (ii) accumulation of cases and economic costs for the companies; and (iii) legal uncertainty. The uncertainty associated with outcomes determined by the courts is a deterrent for all businesses, but has a particularly strong impact on micro and small busi-

¹⁴ Although the current IMF Arrangement expires in February 1, 2004, it is widely expected that the Government of Peru (GOP) and the Fund will subscribe a new Stand-By Arrangement for the period 2004-2006. In the unlikely case that a new arrangement of this type is not pursued, the Bank will evaluate compliance through reliance on the MMM, its own assessment of the macroeconomic policies of the Peruvian Government, and an official IMF letter assessing the GOP's economic conditions and policies.

¹⁵ Instituto APOYO. "Proyecto de especialización comercial para el Poder Judicial. Creación de Instancias Jurisdiccionales Especializadas en Materia Comercial. Aspectos Organizacionales y Funcionales". Lima, Diciembre 2001.

nesses. Approximately 93% of the surveyed micro and small businesses do not use the established system to resolve conflicts because of both their lack of confidence in the system and the high transactions cost of accessing the system in terms of cumbersome and slow procedures. In August 2003 a Commission of Supreme Court Magistrates published, and the full court endorsed, a report on judicial reform including the civil courts. The report calls for the creation of separate commercial courts, however additional implementing studies are needed before the full Supreme Court can formally create the commercial courts.

- 2.14 **Objective and justification.** Improvement in the application of justice in relation to commercial issues will contribute significantly to the reliability, predictability, and stability of the contractual relationships that are essential to efficient, low-cost business operations. Specifically these reforms would encourage more homogeneity in the sentencing criteria, which would allow for more predictable judgments, as well as encourage the greater use of the judiciary to resolve conflicts, thereby contributing to improved law enforcement. Also a more dependable and predictable judiciary would allow for investing in profitable but risky activities, where the credibility of legal safeguards would help to mitigate some of the risks.
- 2.15 **Program Initiatives.** By first tranche the President of the Supreme Court will commit to support a plan for implementing the proposal to create self-sustaining specialized commercial courts Lima , Callao, and the northern cone as well as in selected provincial cities. The results of the current study of adjustments to court fees will be taken into account in this plan.. By second tranche, the Supreme Court will have created at least seven financially self-sufficient commercial courts in the greater Lima area, either through conversion of existing civil courts or by creation of new courts.

b) Improvements in arbitration and other extra-judicial systems of conflict resolution

- 2.16 **Background.** The two primary types of alternative dispute resolutions mechanisms (ADRM) in Peru are arbitration and mediation. Specific problems related to the arbitration process are; (i) it is not widely used; (ii) there is a general lack of information of how arbitration works, especially among small and medium enterprises; and (iii) the procedures lack transparency. With respect to mediation, it is not perceived to be working as well as it should; there is no institutional support behind mediation centers, and the mediation process is excessively formal given its non-binding nature.
- 2.17 **Objectives and justification.** The process of binding arbitration is an attractive alternative to court procedures for many businesses. The objectives of this element of the program are to inform small and medium enterprises of the benefits of these alternative procedures, to provide additional transparency to the arbitration and mediation processes and ultimately to streamline and rationalize the costs associated with these processes. The potential benefits of reform include a more developed extra-judicial system and should result in small and medium businesses

perceiving arbitration and mediation as viable alternatives to the court system and availing themselves of such services, thus decreasing the burden on the court system. Probable benefits to these firms would include decreased direct and indirect costs and a more expeditious resolution of the issues.

- 2.18 **Program Initiatives.** Prior to first tranche, the Ministry of Justice will develop a plan of action, which contemplates the systematic dissemination of information related to the individual arbitration centers. The Ministry will invite the arbitration centers to submit data on the services rendered. This will be published on the Ministry website along with relevant links, thereby increasing the transparency of the process and stimulating competition among the centers, based on market forces. Included among the information to be provided by participants are the following; (i) the rates charged by each center for services rendered; (ii) the number and types of cases heard and elapsed time involved in reaching a decision; and (iii) the number of cases which subsequently were referred to the judicial system. The action plan also should include the design and development of an electronic system that permits the users to have access to current information related to the operating procedures and regulations of the arbitration centers. Furthermore, a system of information dissemination needs to be presented in the action plan. This dissemination strategy should include the organization and planning for four conferences organized by the Ministry of Justice with participation of the Bar Associations, lawyers and representatives from both the judicial and business sectors for the purpose of discussing the respective advantages of the arbitration process and sharing information on recent market developments. Finally, with respect to mediation, as a condition precedent to first disbursement terms of reference will be developed for an evaluation of the costs and benefits for commercial cases of the obligatory mediation system and the possibility of reforming it accordingly.
- 2.19 Prior to second tranche disbursement, the referenced information system should be operational. Information to be made available on the website includes statistics for each participating center on the number and type of cases presented for arbitration as well as the rates charged. The website should also include a link to the individual arbitration centers so that the reader has access to the operating procedures and regulations. A minimum of two conferences should have been held focusing on dissemination of information related to arbitration. Also, the analysis of the obligatory mediation system should have been completed and actions taken to initiate some of the reforms suggested in the study.

c) Streamlining bureaucratic procedures to facilitate business' participation in the formal sector

- 2.20 **Background.** A key impediment to more competitive businesses is the transactions cost of doing business in Peru. Firms must make numerous payments in order to execute a transaction, and there are numerous delays and duplication of functions and costs among various government entities. In recognition of the suffocating effect of these impediments, a “Ley de Eliminación de Barreras Burocráticas en Favor de la Competitividad de los Agentes Económicos” was ap-

proved and published on July 19, 2003, which provides a framework for reducing or dispensing entirely with bureaucratic barriers to business activity.

- 2.21 **Objective and justification.** Peru is dominated by informal business in terms of number of enterprises if not in value of sales. Reducing the time and uncertainty associated with complying with all government requirements to carry out legitimate, formal business operations would provide a powerful incentive for micro- and small-business to move into the formal sector and benefit from the more stable environment it provides. The costs of implementing a system for monitoring bureaucratic procedures (*sistema de información y monitoreo de trámites administrativos* - SIMTA) and publicizing them are low (developing of statistical base, creation of forms for officials, training of government officials, etc.). It is expected that such a system in tandem with the new law would (i) improve the transparency of the procedures for citizens and enterprises; (ii) motivate the public officials to perform their duties in the most efficient manner possible; and (iii) provide an additional tool for performance evaluation of the officials. In turn, this would be expected to lead to decrease time periods for processing the administrative requirements of businesses.
- 2.22 **Program Initiatives.** For first tranche a plan of action will be agreed to (i) develop SIMTA in those national government agencies which deal directly with businesses; (ii) create a unified central registry of functions and procedures associated with business; (iii) create the institutional framework for developing and administering *e-government* such that it will facilitate private sector compliance with bureaucratic requirements; and (iv) define the procedures and agencies which will be reformed during program execution.
- 2.23 By second tranche (i) SIMTA will be operating in the agreed agencies; (ii) the unified registry of bureaucratic functions will be implemented; (iii) the times required for creating and running a business will be reduced by 30% and 20% respectively, thus raising Peru's performance above the Latin American average; and (iv) *e-government* tools for facilitating business transactions will be in place.

C. Enterprise competitiveness

1. Infrastructure

a) Guidelines for transport policy formulation

- 2.24 **Background.** The lack of adequate investment in transportation infrastructure, in addition to the poor public and private management of existing assets, is a major deterrent to the improved competitiveness of Peru. Given the scarcity of public resources, private investment in transportation is essential, particularly in those areas where private investors can recover the cost of their costs directly from infrastructure customers. Government needs to offer a stable legal climate with clear sustained signals over time in order to encourage private participation.

- 2.25 **Objectives and justification.** The lack of a national policy for transport infrastructure and related services is exacting a toll on the country's overall productivity and competitiveness. A policy is needed which emphasizes the indispensable participation of the private sector and calls for an adequate legal and institutional framework based on a long-term, business-oriented vision of development in the sector. The guidelines should cover activities related to highway transportation and ports, where private sector participation can bring a qualitative difference in the price, scope and quality of services provided.
- 2.26 **Program Initiatives.** For first tranche, the guidelines will be prepared that cover those areas where private sector management and investment would improve the scope of infrastructure and transport services provided to the public, and increase the quality of maintenance and operations, including; urban and inter-urban truck transport; port, airport and other transport terminals; financing, operation and maintenance systems. The policy should provide for different modalities for private sector participation, decentralization of transport functions, and appropriate environmental safeguards. In order to improve the business environment, the regulatory, supervision and control capabilities, associated with the formalization of transport services and its operators, should be addressed. For second tranche a transport policy dealing with the above issues will be vetted by the CNC and published by the Government.

b) Improved ports administration

- 2.27 **Background.** Investments in port improvements and modernization have been negligible in recent years adversely affecting logistical costs and the competitiveness of the Peruvian port system and overall economy. The Global Competitiveness Report places Peruvian port infrastructure as the second worst in South America. Recent estimates also show that port costs for container services in Peru exceed the world average by 30-70%. This has been compounded by the lack of a legal framework and clear rules to promote the effective participation of the private sector in port development. Recognizing the urgent need to improve port efficiency, decrease costs and prices, improve service quality and increase competitiveness, Peruvian authorities decided to increase private sector participation through concessions of all major ports in the late 1990s, excluding Callao, the largest port in the country, and the concession of one port, Matarani, was let to a private operator.
- 2.28 In early March 2003, Congress approved the National Port System Law, whose main objectives include promoting the development and competitiveness of the port system, facilitating multi-modal transport, modernizing port infrastructure and developing the logistical chains in which these ports participate. This legal framework establishes the broad guidelines of a national port policy, the need for a national plan for port development, and the new institutional structure for the sector, creating national and regional port authorities responsible for technical, operational and administrative aspects of port operations. It also assigns responsibility for the regulatory and competition functions, opens the sector to the par-

ticipation of the private sector in port development and modernization, establishes different modalities to promote this participation, and ensures that aspects related to environmental protection properly follow national legislation and related international regulations.

- 2.29 **Objectives and justification.** By supporting the preparation and approval of the implementing regulations and the establishment of the institutional structure, the program will promote the definition of clear rules of the game and a division of sector responsibilities. It will also apply this new institutional structure and technical, economic, financial, social/environmental rules by calling for bids on private investment in a public port, utilizing a competitive and transparent process. While only a first step, this private investment should send an unmistakably clear signal to potential investors of the Government's commitment to mobilize much needed resources for the reactivation and modernization of the port system. This will ultimately reduce logistical and transportation costs and improve the competitiveness of the port system and overall economy.
- 2.30 **Program Initiatives.** By first tranche, the regulations of the new legal framework should be approved and published. These regulations should clearly separate the technical, operational and administrative functions under the new port authorities from the economic regulatory functions under OSITRAN, the regulatory agency for the transport sector; and should also establish the socio-environmental framework for sector operations.
- 2.31 By second tranche, the new institutional structure resulting from this new framework will be established with clear roles and responsibilities and adequate financing assigned to the Ministry of Transport and Communications as the policy making body; the national and regional port authorities as the bodies responsible for the technical and operational aspects of port operations; OSITRAN as the economic regulatory body; INDECOPI as the agency responsible for overseeing competition in the sector; ENAPU as the administrator of public port infrastructure; and the institution responsible for monitoring and supervision of socio-environmental aspects related to port operations. Also by second tranche, a request for proposals (RFP) will be issued for private investment in an economically important port via a competitive and transparent international bidding process.¹⁶ The RFP will include the investors' rights and responsibilities under the new institutional structure, including required investments, and socio-environmental aspects. Due consideration will be given to informing the population about the potential socio-economic benefits resulting from investments in this sector, including those carried out by the private sector.
- 2.32 **Related issues for the Policy Letter.** Minimizing regulatory risk contributes to the effective participation of the private sector as a partner in the development and

¹⁶ The terms of the concession will be consisted with the decentralization process and associated legal and institutional reforms currently under way in Peru.

financing of much needed infrastructure. Also, promoting effective competition is critical for encouraging investment and competitiveness, ultimately promoting the welfare of the population and sustainable economic development. Therefore, these policy measures on ports will be complemented by the Government's continued efforts to strengthen the autonomy and stability of regulatory and competition agencies for all infrastructure sectors. This commitment will be included in the program's Policy Letter.

2. Financial services

- 2.33 The Peruvian financial system underwent profound structural reforms in the 1990s resulting in a system that is much more market oriented and capable of robustly providing financial services. The system started from a base of extreme financial repression with credit to the private sector as a proportion of GDP at 6.7 percent in 1990 and rising to 27.9 percent in 1999. However this is still below the 38 percent expected for a country of Peru's per capita income. Beyond liberalizing interest rates, eliminating taxes on financial intermediation, and privatizing commercial banks, several reforms are still necessary to improve access to credit and other financial services. Recently a new bankruptcy law was approved which substantially simplifies the procedures. The remaining reforms have to do with more rapid conflict resolution and improved creditor rights. The judicial and extra-judicial reforms supported by the PBL will address the former issue, and the reforms in the financial sector described below are designed to address the latter issue.

a) Improved access to credit histories

- 2.34 **Background.** One of the problems faced by financial intermediaries is the lack of reliable information on the creditworthiness of borrowers, based on a history of credit and payment experience. To address this problem the Superintendency of Banks created its own credit bureau (with Bank support) and encouraged the formation of private credit bureaus to gather and process additional information (including both information from the banking system and information from other sources). Two are in operation, however financial information on business borrowers, particularly small and micro-businesses, is incomplete.
- 2.35 **Objective and justification.** Improving the quality and quantity of information on businesses will aid banks in making credit decisions (better risk discrimination and reduced processing time). As such, creditworthy borrowers, especially smaller enterprises and individuals should be able to obtain better terms and conditions for financing.
- 2.36 **Program Initiatives.** For first tranche the Superintendency of Banks and Insurance (SBS) will have initiated the process of (i) standardizing financial statements of commercial loan borrowers, including small enterprises; and (ii) systematically archiving this information in credit bureau files.

- 2.37 For second tranche the SBS will have concluded the standardization process for all borrowers with commercial loans (representing at least 70 % of all borrowers), and the resulting improved credit ratings will be fully available for dissemination by the credit bureaus.

b) Facilitation of guarantees on moveable property

- 2.38 **Background.** The legal and institutional structure surrounding secured transactions is critical to the ability of the financial sector to support a more competitive business community. The security in “secured” transactions cannot be executed rapidly and dependably, resulting in higher risk to creditors. Many potential borrowers are excluded from credit markets, as the collateral that they can offer is not considered acceptable. Those who do obtain credit get little improvement in the terms and conditions of their loans because the process of creating and perfecting collateral is cumbersome, time consuming and expensive. Multiple registry systems are in use with different rules and regulations depending on the economic sector or location of the registry. The execution of guarantees is likewise costly and time consuming due to delays in the administration of justice and lack of clear rules (an average time lag of 31 months calculated by the Bank Superintendency). Over this extended execution period, the value of collateral is wasted and recovery minimized rather than maximized. A conservative calculation of the cost of these delays represents a more than 2% increase in the interest charge for all borrowers.
- 2.39 The Peruvian Government is aware of this problem and has been working on the issues surrounding secured transactions for several years. The Bank provided seminal support early in this process with the parallel TC to the Financial Sector Reform Program II (PE-0202) approved in 1999. Since then the government has produced a number of white papers on the issue and has prepared a model law that has been circulated for comment. The Bank has reviewed the draft and proposed improvements to reflect best international practice.
- 2.40 **Objective and justification.** The objective is to enable borrowers to use their moveable property, i.e. most assets other than real estate, as collateral for bank loans. The benefits of the reform are significant. From the perspective of the borrowing enterprise, there should be significant gain with respect to improved access to credit (especially for smaller firms), improving the terms and conditions of credit operations, and speeding up the credit decision. From the perspective of lenders, the measures should reduce the cost of setting up guarantees and reduce credit risk.
- 2.41 **Program Initiatives.** For first tranche the law containing satisfactory provisions regarding the use of secured transactions to support credit operations will be presented to Congress. The law will incorporate, among other considerations: (i) the ability to handle hybrid & simulated guarantees; (ii) the use of mortgage portfolios as guarantees; and (iii) securitization. The law will also include chapters on rights of international creditors, transition provisions, definitions of products ac-

ceptable to be used as guarantees, and a complete listing of provisions in previous laws, which are superceded by the new law. The implementing regulations will (a) enable private management of guarantee registries; (b) clarify the judicial procedures for executing guarantees; (c) establish clear priorities regarding creditor rights; and (d) assure that the creditor is not exempt from the process of asset restructuring. By second tranche the regulations for the law should be in effect and the new procedures for registration of guarantees should be operational.

- 2.42 **Related issues for inclusion in the Policy Letter.** The program will support moving forward and not reversing financial sector reforms that have been implemented to date. Specifically the authorities need to: (i) maintain the subsidiary role of the State in credit markets and other operations of the financial sector; (ii) continue to assure adequate legal and regulatory framework as the primary role of government (in order to support the development of private financial intermediaries; (iii) extend financial services via solvent private financial intermediaries; and (iv) recognize the benefits of assigning financial resources based on market prices. With respect to better penetration of financial markets, the Government will, among other initiatives, carry out an information campaign on the importance of borrowers maintaining a good credit history, and reduce impediments to private financial institutions expanding into rural areas (including the expansion of the services of credit bureaus to rural areas). These commitments to maintain and move forward on past financial reforms are included in the Policy Letter.

3. Labor training

a) Accreditation of worker training institutions and certification of worker competencies

- 2.43 **Background.** The Peruvian labor market is characterized by very low levels of worker productivity, which is reflected in low salaries. The corollary of this low productivity is poor work environment in which there are neither incentives nor resources to provide minimum social benefits. By the same token investment in training is very low, which in addition to the problems of the basic and secondary education system, reflects the serious deficiencies of occupational training institutes, which offer highly differentiated but overall very low quality training. Meanwhile neither a regulatory nor an information system is available to help both potential trainees and firms to choose the training options that best fit their needs.
- 2.44 In addition to poor quality of occupational training institutes, the labor market is characterized by pronounced information asymmetries between firms and workers. These include high transaction costs as well as entry barriers and rigidities that affect the horizontal and vertical mobility of the work force. In Peru, these asymmetries are accentuated because no information is available on the characteristics of different levels of the labor force. This causes many firms to invest heavily in staff selection, recruitment and induction processes. Meanwhile, individuals who in the course of their working career have acquired skills useful for their jobs

find it impossible to be accredited for these competencies, which leads to inequity, the under-utilization of human resources and economic losses.

- 2.45 **Objective and justification.** The program will establish an institutional accreditation system for the *Institutos Superiores Tecnológicos* (ISTs) and *Institutos Superiores Pedagógicos* (ISPs) and a pilot competencies certification system for workers in the textiles sector. The pilot competencies certification system will provide objective parameters for measuring levels of job competency in relation to performance levels required by specific occupations. The system will also provide practical guidance to businesses, the public sector, training agencies and the work force in general, on pertinent information relating to the labor force. The main benefit of both the accreditation and competencies certification systems is the incentive they will provide to improve the quality of the training and to reduce the transaction costs, entry barriers and rigidities that affect the horizontal and vertical mobility of the work force.
- 2.46 **Program Initiatives.** For first tranche (i) the Ministry of Education will agree to the detailed design of a system for the evaluation and accreditation of ISTs and ISPs will be established, and (ii) a system for the standardization and certification of workers' skills will be initiated based on a pilot case sponsored by the Ministry of Labor and Employment Promotion. For second tranche both systems will be operative and meeting specific evaluation and certification targets, namely; self evaluations of 100 ISTs and ISPs and outside evaluations of an additional 20 such institutions, validation of 10 norms for technical skills and 30 workers evaluated in the pilot certification area.

b) Strengthening training programs

- 2.47 **Background.** Worker productivity is low in Peru and the available evidence indicates that more than 60% of the work force has not received occupational training. Training is currently limited to those who can afford the fees charged by private training institutions or for a limited number of formal-sector workers benefiting from employer-funded training programs. However there are no tax incentives to provide training, and public funded training programs are almost nonexistent, with the exception of *Programa Projovent*, a publicly-funded but privately-delivered training program providing classroom training, on-the-job training, and job search assistance for youth.
- 2.48 **Objective and justification.** The government needs to channel more resources into demand-oriented training programs that: (i) are tailored to the specific needs and characteristics of the target group; (ii) have a competitively awarded (public and privately provided) delivery mechanism; (iii) designed with employer feedback; and (iv) are subject to continuing impact evaluation. Specifically the government will establish two new training programs. The first, *Bonopyme*, will be aimed at training workers and owners of micro- and small-firms with the objective of improving the productivity of these workers. Vouchers will be supplied to the firms, enabling them to select the training operator of their choice. The pro-

gram will provide each firm with (a) information on accredited operators and (b) technical assistance on a cost-sharing basis tailored to the specific needs of each firm. The second program, *Bonoemprende*, will be aimed at training youth on how to start up their own enterprises. A similar voucher-based delivery mechanism will be used. Training will be supplemented with business counseling. Both programs will have impact evaluation components. In the case of *Bonopyme* the evaluation will focus on assessing increments in productivity of both firms and employees. In the case of *Bonoemprende* the evaluation will focus on assessing the survival rate of the new businesses.

- 2.49 **Program Initiatives.** For the first tranche, operation of both programs will be initiated and output goals will be established in terms of number of beneficiaries and investment. In addition, the budget resources to achieve those goals will have been allocated, and the baseline information for the impact evaluation of both programs established. For second tranche these programs will be operating with a 16,600 beneficiaries trained in 2004 and similar goals required for 2005.

4. Technology

a) Public funding for research based on evaluation of benefits

- 2.50 **Background.** Resources allocated to science and technology are very limited. Peru invested 0.08% of its GDP in research and development in 1999, which is far below the average of 0.54% invested by the Latin American and Caribbean region during that year. An important share of the science and technology resources are allocated to several public technological and research institutes, most of which are linked to various sector ministries. A major portion of the funding for these institutions is allocated via budgetary inertia and/or earmarking. Very few obtain significant revenues from sale of their technological services, thus their survival depends almost exclusively on public budgets. Consequently, these institutions have little incentive to identify, much less respond, to industry demand for research and technological services. They remain disconnected from the needs of industry, and are essentially unaccountable for their expenditures.
- 2.51 **Objective and justification.** The objective is to establish a system for assessing public technological and research institutes in order to ensure their accountability and relevance. Once the system is established, a subsequent objective is to modify the current inertia-based budget allocation methodology and introduce, for at least a portion of the public funds, allocation criteria based on performance and pertinence of research activities. The new rules for resource allocation will promote transparency, objectivity, and peer review and evaluation procedures, assuring that merit, performance and relevance are the main criteria for research funding. Among the specific criteria to be considered for resource allocation are: (i) the quantity and quality of the research; and (ii) the relevance of that research. Regarding the first, consideration must be given to Peru's relative focus on the diffusion of existing knowledge via application of known technology to specify industry requirements rather than the creation of new knowledge through cutting-edge

research. Regarding the second criteria, the institutions should be rewarded for proposals, which demonstrate a close linkage to, and complementary funding from, the productive sector.

- 2.52 **Program initiatives.** For first tranche, an assessment system for public technological and research institutes will be designed, including: (i) the definition of the institutions to be assessed; (ii) the assessment criteria; (iii) the assessment methodology; (iv) the assessment coordination unit; and (v) an action plan for the assessment activities. By second tranche at least 15 % of the public funds will be allocated to these institutions based on an impact assessment of their performance and on competitive selection of research proposals.¹⁷

b) Information and communications technology (ICT)

- 2.53 **Background.** Peru has advanced in introducing competition in telecommunications, although greater efforts should be made in this critical area, and in financing access to telephone services in low-income areas through the FITELE Program. Lower telecommunications access costs have permitted the establishment of a network of telecenters (*"cabinas"*) that number more than 2,000 and that provide access at very reasonable rates (about US\$0.30 per hour). Nevertheless, Peru, in contrast with other countries in the region such as Colombia, does not have a national strategy to promote greater use of ICT in the public and private sector. A Bank-funded ICT study strongly recommended establishing a commission to develop a strategy and action plan for ICT. On June 7, 2003, the PCM issued a Ministerial Resolution creating the Multisectoral Commission for the Development of an Information Society (CODESI).
- 2.54 **Objectives and justification.** Up to now, Peru has embarked on numerous initiatives to promote greater use of ICT, but there has been a lack of coordination and a duplication of efforts. The creation of CODESI and the formulation of the Plan will contribute importantly to greater strategic thinking and to the rationalization of resource allocation in the ICT sector.
- 2.55 **Program initiatives.** For the first tranche, the CODESI members will have been named, the Commission will have met and its internal regulations will have been issued. Funding will be provided for support the drafting of the Plan.
- 2.56 For the second tranche, the Plan will have been drafted and it will have been approved by the PCM. This plan is expected to deal with improvements in: (a) the legal/regulatory framework for (i) promoting competition in telecommunications and (ii) *e*-transactions; and (b) increasing human capital in ICT; and (c) promoting *e*-government.

¹⁷ These criteria for allocating resources will be consistent with the approach being used in the Science and Technology Program, (PE-0203) currently under preparation in Peru with Bank support, including the use of selective public matching grants for privately funded initiatives.

2.57 **Related issues for inclusion in the Policy Letter.** Coordination of policy formulation between stakeholders in the science and technology sector remains weak despite recent efforts by the National Council for Science and Technology (CONCYTEC), the Ministry of Production, and other institutions to collaborate more closely. Allocation of public resources to the sector is not driven by sector priorities, nor is there much collaboration and coordination between R&D institutions and the productive sector. To rectify this situation, a high level consultative group needs to be established for science, technology and innovation, with the participation of the government, the private sector and the scientific-university community. The group would mainly play two roles: (i) provide advice at the highest levels of government on policy issues; and (ii) stimulate public discussion on topics related to the role of science, technology and innovation in the development of the country.¹⁸ The Letter of Sector Policy contains a government commitment to propose the creation of such a consultative group under the aegis of the CNC.

D. Formation of Productive Associations (*Clusters*)

2.58 **Background.** One of the conclusions of competitiveness studies in Peru is that chains of production are fragmented, which implies few links between firms in similar activities or with supporting industries and institutions. A study by the Universidad del Pacifico¹⁹ concluded that there is very limited linkage between the public, private sectors and academia; regional planning for competitiveness is non-existent; there is no mechanism for private/public sector cooperation in regional planning; and there are no monitoring and evaluation systems for the few *cluster* programs that exist. Yet, given the prevalence of micro, small and medium enterprises in the Peruvian economy, chains of production and clusters can have an important effect on the competitiveness of enterprises.

2.59 **Objectives and Justification.** Concerted programs to promote clusters have been implemented in other countries; e.g. Chile and México. These programs are demand driven, require significant leadership and commitment from private sector participants, and have established monitoring systems to measure effectiveness. A program following these principles in Perú can contribute to the creation of social capital in clusters and to an increase in enterprise competitiveness. The main features of this program will be: (a) increased coordination between the different agencies supporting enterprise development; (b) training on cluster development for key individuals from the public and private sectors, and academia; (c) leadership by a public institution for the cluster support efforts; and (d) establishment of an agile and transparent cluster support mechanism.

¹⁸ The GoP, with the support of the Bank, is currently preparing a Program on Science and Technology, whose conceptual approach, and emphasis in stimulating the linkages between research and technological application by the private sector is consistent with the measures proposed in the present PBL.

¹⁹ Alejandro Hermoza y Otilia Caro, *Redes Estratégicas para la Competitividad*, Universidad del Pacífico, diciembre 2001.

- 2.60 **Program initiatives.** For first tranche, the executing agency and members of the inter-agency coordinating group will be designated and a plan of action will be agreed which includes: a) coordinated actions to support clusters; b) specific measure to promote decentralization; c) training in the promotion of clusters (“conglomerados” or “esquemas asociativos”); and (d) establishment of a funding mechanism with transparent processes to support activities that lead to greater social capital in clusters.
- 2.61 For second tranche, a) the coordinating group will be established; b) the training program will be completed; c) the institution to manage the fund will be contracted and d) the fund will be operational; and e) one cluster program will be initiated with seed money provided by the Support Fund (see chapter III).²⁰

E. Cost and financing

- 2.62 The Program is considered under the policy-based lending facility approved by the Board of Governors (Resolution AG-1/02). The total loan amount is \$300 million to be financed from the resources of the Single Currency Facility of the Ordinary Capital of the Bank. The loan will be disbursed in two tranches of \$200 million and \$100 million respectively.

²⁰ Independent of the PBL, a MIF program is under preparation to further elaborate on and develop the cluster program.

III. PROGRAM EXECUTION

A. The borrower, guarantor and executing agency

- 3.1 The Government of Peru will be the borrower of this sector loan. The Ministry of Economy and Finance (MEF) will be the primary executing agency.

B. Program execution and administration

- 3.2 **The sector reform program.** As noted, the Ministry of Economics and Finance will be the overall executing agency and will coordinate the various components of the program with the other ministries by means of agreements (*convenios*) signed with each one. The Presidency of the Council of Ministers (PCM) will be the sub-executing agency directly responsible for the reforms of the CNC and implementation of the National Competitiveness Strategy. Other sub-executing agencies will be the Ministry of Transport and Communications, the Ministry of Labor and Employment Promotion, and the Superintendency of Banks and Insurance. The Vice Ministry of Economy, via its International Economics, Competition and Private Investment Department (*Dirección General de Asuntos de Economía Internacional, Competencia e Inversión Privada – DGAEICIP*) will lead the public-private technical coordination group which will oversee the cluster promotion program.
- 3.3 The agreements signed between the MEF and the sub-executors prior to utilization of technical assistance funds will stipulate the mechanism for managing the these funds and for resolving disputes between the parties over policy and other substantive issues which may arise during program execution. Within the MEF, the Sector Loan Coordinating Unit (*Unidad de Coordinación de Préstamos Sectoriales – UCPS*) will be responsible for coordinating the administration of the technical assistance funds, while the DGAEICIP will be responsible for maintaining a policy dialogue with the sub-executors in order to facilitate execution of the program. The UCPS has hired additional staff to assure that at least one full-time professional will be responsible for execution of the program. Also the UCPS contract management system will be improved through increased automation. The DGAEICIP will hire additional staff to manage the cluster promotion and inter-agency coordination functions.
- 3.4 **Disbursement of the loan resources** will be in two tranches of \$200 million and \$100 million respectively. The “front loading” is justified by the considerable progress Peru has already achieved in moving forward with its competitiveness agenda, as noted in the Policy Letter and in the prior actions (*acciones previas*) section of the policy matrix. Most importantly the borrower has committed to undertake numerous and substantial measures prior to first tranche release, several of which are expected to be completed before Board presentation.
- 3.5 **Related technical support.** At the time of first disbursement the Government will create a special account for a support fund (SF). Within 15 days from the date of

first disbursement, the Government will deposit an estimated US\$5.0 million in the account. The Fund will finance all technical assistance activities required to achieve the goals of the program, in general, and the conditions of the second tranche in particular. The MEF will collaborate with the sub-executing agencies in the procurement of consulting and other services according to the terms of the inter-agency agreements mentioned above. Annex IV lists the technical support activities to be carried out in parallel with the operation and their estimated costs. In summary, support will be provided for (i) the CNC technical secretariat, the consultative groups, and an interim evaluation of the CNC, (ii) monitoring and evaluation of the implementation of the national competitiveness strategy; (iii) implementation of the commercial court system and training of its judges (iv) implementation of improvements to the mediation and conciliation systems; (v) the implementation of the system to measure government “red-tape” (*tramitómetro*); (vi) the preparation of the government transport policy paper; (vii) the establishment of the institutional framework for ports administration and private investment in one port; (viii) an information campaign on the importance of maintaining a good credit history; (ix) implementation of the moveable property guarantee system; (x) the implementation of program for accreditation of worker training institutions and worker skills certification program; (xi) training programs for disadvantaged, productive groups; and (xii) the implementation of the system for evaluating public research institutions and assigning budgetary resources accordingly; (xiii) establishment and funding the initial activities of an executing agency to promote cluster development; and (xiv) collection and storage of data necessary for the “outcome” evaluation of development effectiveness. Furthermore, resources will be provided and their expenditure authorized for administrative start-up costs of some programs during the remainder of 2003 and into 2004, until assignment of resources from the normal operating budget can be made. Once the Competitiveness Reform Program is concluded, estimated to be in mid 2005, the sub-executing agencies will assume responsibility for obtaining sufficient ongoing budgetary resources to continue the PBL initiatives and activities.

- 3.6 **Coordination with related Bank and other donor programs.** As discussed in Chapter I, section G, The Bank and other international aid agencies are supporting programs, which complement the present PBL and provide technical assistance for some of its components. The World Bank “Trade Facilitation...” program includes funding for the technical secretariat of the CNC to implement its program. The present operation provides funding only for secretariat activities directly related to the PBL. Two Bank programs in execution contain related components, and funding will be coordinated correspondingly. The TC loan, 1196/OC-PE, includes financing for implementation of moveable property guarantees, and care will be taken to draw on these resources first. The Modernization and Decentralization of the State Program (PE-0217) will support the initiatives related to e-government. Finally, as noted in Chapter I, the CAF has earmarked \$3 million in its new hybrid operation to be deposited in the MEF technical support fund for this operation. These monies will be counted as part of the MEF’s contribution to the TSF.

C. Procurement of goods and services

- 3.7 As a PBL, this operation does not contemplate the procurement of goods and services. The GOP has requested that consultancy services under the related TA component be obtained according to standard Annex C procedures.

D. Execution and disbursement schedule

- 3.8 The disbursement period of this sector loan will be no more than 3 years and no less than 18 months from the date of contract signature, as required by the Board of Governors for policy-based lending (AG-1/02). Execution of the parallel technical support activities may extend beyond final tranche release.

E. Monitoring and evaluation

- 3.9 The intermediate results (“outcomes”) expected from the program and the measures of effectiveness are listed in the last column of the table in Annex II. Given the theoretical and practical difficulties of measuring these results, emphasis is placed on the use of administrative records data and “off the shelf” indicators available from the *Global Competitiveness Report* (GCR) and *Doing Business Database* (DBD) which regularly track the competitiveness of economies around the world. Baseline and progress data for each of the indicators will be collected and stored by the borrower for an eventual analysis approximately two years after final tranche release. Data pertaining to the execution period will be available for review at the time the PCR is prepared. Guidelines for this purpose have been prepared with the collaboration of the executing agency that specify (i) the full definition of each indicator, (ii) its baseline value, and (iii) the methodology to be used in its collection and analysis. These guidelines are available in the project files.
- 3.10 In accordance with the policy on Ex-post Evaluation of Operations approved by the Board of Executive Directors on October 15, 2003 (DEA/03/40, see also GN-2254-5), the information will be available for OVE and other interested parties to carry out analyses and prepare reports, according to their own criteria. The Ministry of Economy and Finance has declined to carry out a Borrower’s Ex-post Evaluation.

IV. VIABILITY AND RISKS

A. Environmental impact

- 4.1 As a policy-based program this operation will have no direct environmental impacts. However, specific measures will be incorporated to supervise properly any indirect impacts generated by the policy measures on labor, technological innovation, and ports. The evaluation system for public technological and research institutes will consider the environmental impact of research that may result in productive activities. The criteria for the accreditation of training institutions will include observance of environmental standards. The textiles sector skills certification pilot system will consider environmental management in the definition of occupational norms. (See discussion of socioeconomic viability below.)

B. Social impact and benefits

- 4.2 The executive summary provides an overview of the benefits, which may be further described as follows: At the national level, the CNC will not only provide a forum for consensus building on country-wide issues but also help to distill national implications of discussions held by the consultative groups on sector-specific and local issues as well.
- 4.3 At the sector level, the judicial reform will (a) bring much needed expertise and prompt attention to disputes on commercial matters, and (b) will assure funding for the courts by charging self-sustaining fees, that will be more than offset by the savings to the business community represented by more opportune and predictable judgments. Arbitration system reforms will lower access costs and raise confidence in extra-judicial system, thus giving potential litigants a choice between two good dispute resolution alternatives rather than having to settle for the lesser of two evils. The regulation of the new National Ports Law will promote clear rules and a division of oversight responsibilities in the sector, so as to minimize potential conflicts of interest. The call for bids on one port will send a clear signal to potential investors that the government is committed to lowering shipping costs. The proposed changes in financial services will aid lenders both in making better informed credit decisions and in more expeditiously recovering the value of their assets in the event of a borrower default, thus expanding access to credit. In labor markets, the proposed system of accreditation for worker training institutes will allow employers and potential trainees, particularly the poorest, to more intelligently allocate their limited budgets. An expansion in training programs focused small and micro-enterprises will counteract the shortfalls of the formal education system for these groups. Technological innovation will be enhanced by the proposed improvements in conditions for scientific and technological investment, thereby generating new processes and products and raising productivity. At the local level, the promotion of productive associations (*clusters*) should provide a much-needed impetus for public-private collaboration on specific business initiatives.

C. Beneficiaries

- 4.4 Because this is a multi-sector reform program, many and diverse groups will benefit. In the case of the labor market reforms however, those workers participating in the certification programs will receive direct benefits. More broadly the actions supported by this operation will benefit the business community at large, including small and micro-enterprise as noted previously by reducing the costs and uncertainty of doing business.

D. Institutional viability and risks

- 4.5 A general issue, which affects this program, is the uncertain political will and ability to carry out reforms in Peru. Given the composition of Congress and the power of various interest groups it is difficult to be assured that reforms will either be approved as proposed or implemented as approved. The initiatives in the program have been designed to be feasible within this context by being either confined to those within the power of the executive branch or, in those few cases which require action by other branches of government, by building on broadly supported reforms that are well underway.
- 4.6 The single most important risk to the program is failure of the CNC to operate as a credible and widely respected forum for public-private dialogue on competitiveness with a consequent inability to promote and coordinate the national competitiveness agenda. As a condition for first tranche release, the CNC statutes will be modified to enable the private sector (business and labor) to nominate their representatives independently for staggered four-year terms and be removed only for specific cause. The CNC board will also be able to designate its Technical Secretary, who will direct the activities of the support staff. These reforms will encourage a stronger public-private collaboration within the CNC, which in turn will provide more support for implementation of Peru's competitiveness strategy regardless of the administration or government officials currently in power.
- 4.7 A second risk to the program is the possibility that the autonomous Supreme Court may not implement the specialized commercial court judgeships and/or raise the court fees to self-sustaining levels. However the former proposal has been approved by the full Supreme Court and detailed planning for implementation is underway. The latter proposal is actively under study. The policy conditions of the present PBL as well as the parallel technical assistance provide reasonable assurance that the reforms will be carried forward. This reform does not require Congressional action.
- 4.8 The executing agency's inadequate coordination of program implementation represents a third risk. To ameliorate this risk the MEF will sign letters of understanding with each of the line agencies ("sub-executors") detailing the responsibilities of each and specifying conflict resolution procedures.

**PERU. COMPETITIVENESS REFORM PROGRAM
(PE-0239)**

POLICY MATRIX

GOAL	PRIOR ACTIONS	FIRST TRANCHE	SECOND TRANCHE
I. Institutionalization of the competitiveness process: CNC and the competitiveness strategy			
Firm and ongoing public-private cooperation on various levels on competitiveness issues.	Creation of the CNC (23 April 2002; Supreme Decree 024-2002-PCM).	(1) Issuance of a supreme decree on the National Competitiveness Council (CNC), providing for, among other things, (a) a process for selecting private sector directors through this sector's own institutional mechanisms, and the appointment of a technical secretary (or equivalent) by the PCM, on the recommendation of the CNC, as well as (b) formation of Consultative Groups.	The CNC is fully operational according to its redefined structure. The evaluation has been completed, and implementation of the applicable changes begun. Among other tasks, the CNC is operating in conjunction with the consultative groups, whose action-oriented proposals are included in the implementation agenda of the National Competitiveness Strategy.
	National Forum on Competitiveness (February 2003).	(2). The National Competitiveness Strategy and its implementation agenda have been approved by the CNC, and the strategy adopted by the Council of Ministers.	A system is in operation for (i) monitoring, evaluation and update of the National Competitiveness Strategy and its implementation agenda, and (ii) resolving problems in meeting strategy targets.
II. Environment for private investment			
<i>A. Macroeconomic stability</i>			
Maintain a macroeconomic environment conducive to business growth and higher productivity.	Agreement with the IMF of 18 February 2002. Second review 28 March 2003.	(1) The macroeconomic policy framework is consistent with the program objectives and guidelines set forth in the sector policy letter.	The macroeconomic policy framework is consistent with the program objectives and guidelines set forth in the sector policy letter.

GOAL	PRIOR ACTIONS	FIRST TRANCHE	SECOND TRANCHE
<i>B. Conflict resolution and bureaucratic procedures</i>			
Improve the administration of justice in relation to commercial matters.	The full bench of the Supreme Court of Justice approved the Magistrates Commission proposal for "Creation of Commercial Courts" on 6 August 2003.	(1) <i>Creation of commercial courts:</i> The chief justice of the Supreme Court has committed to support the creation of commercial courts in the districts of Lima, Callao, Cono Norte, and selected provincial towns.	The Supreme Court has set up at least seven financially sustainable commercial courts, and such courts are in operation.
		(2) <i>Improvements in the extrajudicial system:</i> The Ministry of Justice (a) has developed a Plan of Action that calls for the systematic and ongoing collection and publication of data from the arbitration centers in order to carry out : (i) the publication of rates charged for services rendered; (ii) the publication of statistics on cases heard; (iii) the development of an electronic system to provide access to updated information; and (iv) a dissemination strategy; and (b) has drafted terms of reference for a study on the mandatory mediation system and its impact on commercial cases.	The Ministry of Justice (a) has put into operation an information system with the features specified in the Plan of Action, and (b) has completed the study on the mandatory mediation system, and begun taking appropriate action based on the study's conclusions and recommendations.
Facilitate business startup and operation, thereby cutting the applicable costs.	The Law Eliminating Bureaucratic Barriers for Competitiveness of Economic Agents is in effect (Law 28032 published 26 July 2003.)	(3) <i>Bureaucratic processes:</i> The President of the Council of Ministers has approved a Plan of Action to (i) develop a system for monitoring and reporting administrative procedures (SIMTA) for national government agencies with respect to business filings, including a measurement and efficiency mechanism; (ii) develop a unified registry of functions and procedures; (iii) lay the institutional foundation for development of e-government tools for enterprises; and (iv) define the procedures and agencies which will reformed during program execution.	SIMTA is in operation for a set of procedures at the agreed national government agencies, and targets contemplated in the Plan of Action have been met, with a substantial reduction in procedures. E-government tools are fully operational.

GOAL	PRIOR ACTIONS	FIRST TRANCHE	SECOND TRANCHE
III. Enterprise competitiveness			
<i>A. Infrastructure (roads, ports and airports) and public service regulation</i>			
Enhance the environment for private investment in transportation. Increase enterprise competitiveness.		(1) <i>Infrastructure</i> : The Ministry of Transportation and Communications (MTC) has adopted policymaking guidelines for the highway and urban (freight), maritime and air transportation sectors, including allocation of sector responsibilities, design of sector financing policies and methods for private sector participation.	The Ministry of Transportation and Communications has approved and published the agreed policies for the highway and urban (freight), maritime and air transportation sectors, in coordination with the CNC.
Develop clear ground rules and division of sector responsibilities in the management of national ports.	The National Port System Law in effect (Law 27943 of 2 March 2003)	(2) <i>Regulations implementing the National Port System Law (NPSL)</i> have been issued pursuant to a supreme decree authenticated by the Ministry of Transportation and Communications (MTC).	Establishment of the institutional framework contemplated for administering the LSPN, including: (a) national and regional port authorities; (b) working relationship between these and the MTC, OSITRAN, and INDECOPI; and (c) adoption and publication of the National Port Development Plan, giving priority to private investment. A request for proposals calling for private investment in one port or port terminal of economic importance has been initiated.
<i>B. Financing</i>			
Reduce credit uncertainty and help open up new sources of financing		(1) <i>Credit bureaus</i> : The SBS has initiated the process of standardizing financial statements of business borrowers who must report to the SBS credit bureau.	The SBS (i) has fully completed the process of standardizing the financial statements of business borrowers who report to its credit bureau, and (ii) is releasing summaries of such information to the private credit bureaus.
		(2) Congress has been sent a draft Moveable Property Security Act.	The Moveable Property Security Act is in force, a security registry is in operation, and the regulations necessary for its operation have been adopted.

GOAL	PRIOR ACTIONS	FIRST TRANCHE	SECOND TRANCHE
C. Labor training			
Improve information quality and transparency of training programs to raise workforce productivity.	The General Education Act (28074) was enacted on 29 July 2003.	(1) <i>Accreditation/certification</i> : (i) Agreement has been reached to include the design for an evaluation and accreditation system for occupational training institutions in the regulations implementing the General Education Act; and (ii) the labor ministry (MTPE) has developed a pilot worker skills certification system.	Progress on (i) implementation of an evaluation and accreditation system for occupational training institutions, incorporating an evaluation of operations component, and (ii) a pilot worker skills certification system, with validated standards for the textiles sector.
		(2) <i>Training</i> : The labor ministry (MTPE) has initiated occupational training programs for: (i) employees and managers of microenterprises and small businesses; and (ii) young entrepreneurs.	The labor ministry (MTPE) has reached the milestones set for occupational training programs aimed at: (i) employees and managers of microenterprises and small businesses; and (ii) young entrepreneurs.
D. Technology			
Efficient allocation of public funds for science and technology.		(1) <i>Research institutions</i> : Establishment of an evaluation and monitoring system for publicly-funded research institutions.	Allocation of resources to publicly funded research institutions based on: (i) impact evaluation, and (ii) funds awarded by competition.
Increase the use of ICT to raise total factor productivity.	Creation of the “Multisectoral Commission for the Development of an Information Society” (CODESI) (RM 181-2003-PCM).	(2) <i>ICT</i> : CODESI members have been appointed. CODESI has met and approved rules of procedure providing, inter alia, for private-sector and civil-society participation on working groups.	Plan for Development of an Information Society approved. The CODESI report must be approved by the president of the Council of Ministers.
IV. Formation of Clusters			
Create social capital in clusters, to make participating businesses more competitive.		(1) A plan of action has been drawn up to promote cluster strategies, including the coordinating group and responsible organizations, and establishes specific targets.	(i) Operating manual has been prepared; (ii) the fund has been set up, and an institution selected to manage it; (iii) training and dissemination forums have concluded; and (iv) the first project has begun.

**PERU. COMPETITIVENESS REFORM PROGRAM
(PE-0239)**

MEASURES OF EFFECTIVENESS¹

Action Areas		Proposed Measures		Expected Outcomes and Indicators
Problem	Cause	Objective	Output Policy Measures (at program end)	Outcomes (starting two years after last disbursement)
I. Institutionalization of the competitiveness process: CNC and the competitiveness strategy				
The governing body responsible for public-private dialogue on competitiveness is unstable and lacks credibility.	CNC has little autonomy or stature. Political volatility.	Strong and steady public-private consensus on various levels on competitiveness issues.	I.1. The CNC is fully operational according to its redefined structure. The evaluation has been completed, and implementation of the applicable changes begun. Among other tasks, the CNC is operating in conjunction with the consultative groups, whose action-oriented proposals are included in the implementation agenda of the National Competitiveness Strategy.	<u>I.1 Overall outcome:</u> Peru has enhanced its relative position on competitiveness. <u>Indicators:</u> a. Growth Competitiveness Index (GCI): Improvement in relative position of six points [GCR]. b. Microeconomic Competitiveness Index (MICI): Improvement in relative position of six points [GCR]. <u>I.1 Institutional outcome:</u> The national competitiveness process is well established, stable and highly credible to private sector entities. <u>Indicators:</u> c. The CNC has met at least 6 times during the last 12 months. d. At least 10 consultative groups have been set up. e. Each consultative group has delivered at least one report each year.
			I.2. A system is in operation for (i) monitoring, evaluation and update of the National Competitiveness Strategy and its implementation agenda, and (ii) resolving problems in meeting strategy targets.	<u>I.2 Outcome:</u> Performance of the National Competitiveness Process can be measured and evaluated consistently, to ensure continued improvement. <u>Indicators:</u> a. A database of performance indicators is available for monitoring and evaluating the National Competitiveness Strategy. b. The monitoring and evaluation system has produced at least two reports on the performance of the National Competitiveness Process.

¹ DBD: Doing Business Database (maintained by the World Bank Group)
GCR: Global Competitiveness Report (Prepared by the World Economic Forum)

Action Areas		Proposed Measures		Expected Outcomes and Indicators
Problem	Cause	Objective	Output Policy Measures (at program end)	Outcomes (starting two years after last disbursement)
II. Environment for private investment				
<i>A. Macroeconomic stability</i> (not part of the program initiatives)				
<i>B. Conflict resolution and bureaucratic procedures</i>				
Conflict resolution				II.B.1 & 2 Outcome: Justice is administered in relation to commercial dispute resolution with greater transparency, simplicity, and flexibility, within the framework of a system of sustainable specialized courts and an extrajudicial system with well-established and well-known procedures.
Court proceedings in commercial cases are slow, and the decisions of low quality. Lack of confidence in, and credibility of, alternative dispute resolution mechanisms.	Judges lack expertise in commercial matters. Lack of knowledge of how the extrajudicial system functions, or the benefits it provides.	Improve the administration of justice in relation to commercial matters. Streamline the extrajudicial system, thereby lowering the cost of using it.	<p>II.B.1. <i>Creation of commercial courts:</i> The Supreme Court has set up at least seven financially sustainable commercial courts, and such courts are in operation.</p> <p>II.B.2. <i>Improvements in the extrajudicial system:</i> The Ministry of Justice (a) has put into operation an information system with the features specified in the Plan of Action, and (b) has completed the study on the mandatory mediation system, and begun taking appropriate action based on the study's conclusions and recommendations.</p>	<p>Indicators:</p> <p>a. It has been determined the complete first set of seven specialized courts has heard at least 170 cases since the start of their operations.</p> <p>b. Commercial courts charge fees high enough to ensure, in conjunction with other resources, their long-term financial sustainability.</p> <p>c. The electronic information dissemination system for the extrajudicial system is fully operational (fees charged by arbitration centers, types of cases handled, time required, etc.).</p> <p>d. The electronic information dissemination system for the extrajudicial system refers 100 users a month to arbitration centers.</p> <p>e. The Ministry of Justice has held 4 conferences and conducted at least 48 activities to publicize the benefits of arbitration through the mass media (television, radio or press).</p> <p>f. It has been determined that the priority actions identified in the mandatory mediation system study have been implemented.</p>

Action Areas		Proposed Measures		Expected Outcomes and Indicators
Problem	Cause	Objective	Output Policy Measures (at program end)	Outcomes (starting two years after last disbursement)
Bureaucratic procedures				II.B.3 Outcome: Duration and cost of procedures required to register businesses or comply with commercial regulations are reduced in a framework of greater transparency. Indicators: a. An Internet-based system for monitoring procedures (publication of statistics on status, average time and cost) is available for users at the agencies proposed in the SIMTA Plan of Action. b. E-government tools record 500 monthly users that are provided some service through the system (number of “hits” or “downloads”). c. The estimated average time necessary to register a business holds steady at 80 days [DBD].
High cost of submitting to regulation. Disincentive for entrepreneurial activity that favors the informal sector.	Complexity of procedures required to register a business or comply with commercial regulations.	Facilitate business startup and operation, thereby cutting the applicable costs.	II.B.3. Bureaucratic procedures. The SIMTA is in operation for a set of procedures at the agreed national government agencies, and targets contemplated in the Plan of Action have been met, with a substantial reduction in procedures. E-government tools are fully operational.	
III. Enterprise competitiveness				
<i>A. Infrastructure (roads, ports and airports) and regulation of public services</i>				
Lack of an adequate level of investment in transportation infrastructure (ports, in particular), which drives up costs and ad-	(a) No policy or definition of sector responsibilities at the national or subnational levels; (b) No regulations or institutional framework for the sector; and (c) ineffecti	Enhance the environment for private investment in transportation (ports, in particular) and other public services.	III.A.1. Infrastructure: The Ministry of Transportation and Communications has approved and published the agreed policies for the highway and urban (freight), maritime and air transportation sectors, in coordination with the CNC. III.A.2. National Port System Law: Establishment of the institutional framework contemplated for administering the NPSL, including (a) national and regional port authorities; (b) working relationship between these and the MTC, OSI-TRAN, and INDECOPI; and (c) adoption and publication of the	III.A.1 & 2 Outcome: Establishment of an institutional, regulatory and policy framework for the transportation sector that sets out a clear distribution of responsibilities, promotes private sector participation and provides for decentralized management. Indicators: a. The new legal and regulatory framework for the transportation sector is in effect, and it has been determined that responsibilities have been divided among the relevant sector institutions. b. It has been determined that the national and regional port authorities are responsible for technical and operational activities. c. A request for proposals calling for private investment in one port or port terminal of economic importance has been initiated. d. The perception of port service quality improves with respect to the baseline [GCR].

Action Areas		Proposed Measures		Expected Outcomes and Indicators
Problem	Cause	Objective	Output Policy Measures (at program end)	Outcomes (starting two years after last disbursement)
versely impacts enterprise competitiveness.	ve management of the existing infrastructure.		National Port Development Plan, giving priority to private investment. A request for proposals calling for private investment in one port or port terminal of economic importance has been initiated.	
B. Financing				
Potential borrowers are excluded from obtaining credit. Creditor has little security in financing personal property.	Gathering and filing of incomplete and erroneous information. Inadequate legal and institutional framework for putting up personal property as security.	Reduce credit uncertainty.	III.B.1. Credit bureaus: The SBS (i) has fully completed the process of standardizing the financial statements of business borrowers who report to its credit bureau, and (ii) is releasing summaries of such information to the private credit bureaus. III.B.2. Moveable-property security: The Moveable Property Security Act is in force, a security registry is in operation, and the regulations necessary for its operation have been adopted.	III.B.1 & 2 Outcome: Improvement in the quantity, accuracy, and quality of information in credit histories and on availability of collateral for secured transactions. Indicators: a. Increase of 20 points in the index of information gathered for the SBS public credit bureau [DBD]. b. The secured transactions system is consolidated and simplified, allowing for creation, perfection and execution of guarantees.
C. Labor training				
Insufficient information on occupational training institutions. High transaction costs in	There is no (a) system to guarantee training quality; (b) mechanism for worker skills certification; and (c) incentive programs	Increase quality and transparency of information on occupational training institutions and worker skills, to raise workforce pro-	III.C.1. Accreditation/certification: Progress on (i) implementation of an evaluation and accreditation system for occupational training institutions, incorporating an evaluation of operations component, and (ii) a pilot worker skills certification system, with validated standards for the textiles sector.	III.C.1 & 2 Outcomes: Employees and managers of small- and medium-sized enterprises have access to worker training programs, and information is available on the quality of occupational training institutions and on the skills of textile workers.

Action Areas		Proposed Measures		Expected Outcomes and Indicators
Problem	Cause	Objective	Output Policy Measures (at program end)	Outcomes (starting two years after last disbursement)
the labor market. Limited occupational training opportunities	or mechanisms for occupational training.	ductivity.		
			III.C.2. Labor training: The labor ministry (MTPE) has reached the milestones set for occupational training programs aimed at: (i) employees and managers of microenterprises and small businesses; and (ii) young entrepreneurs.	Indicators: a. An information system for the accreditation and evaluation of occupational training institutions is in operation. b. 120 upper-level teaching or technological institutions have been accredited. c. 50 technical/manufacturing institutes have been accredited. d. A ranking of occupational and business training institutions and programs is available. e. The occupational skills of 100 workers have been evaluated, two years after the second disbursement. f. The occupational skills of 60 workers have been certified. g. The garment sector has validated 32 standards for occupational skills, two years after disbursement of the second tranche. h. 37% of businesses started by young entrepreneurs are still operating in the market, one year after receiving program services.

Action Areas		Proposed Measures		Expected Outcomes and Indicators
Problem	Cause	Objective	Output Policy Measures (at program end)	Outcomes (starting two years after last disbursement)
<i>D. Technology</i>				
Re-sources allocated to (a) science and technology activities, or (b) telecommunications, have little impact.	Historical budget allocation to technological research institutes and other institutions. No national strategy to promote greater ICT use.	More effective allocation of public funds for science and technology. Increase ICT use in the public and private sectors.	<p>III.D.1. Research institutions: Allocation of resources to publicly funded research institutions based on: (i) impact evaluation, and (ii) funds awarded by competition.</p> <p>III.D.2. ICT: Plan for Development of an Information Society approved. The CODESI report must be approved by the president of the Council of Ministers.</p>	<p>III.D.1 and 2 Outcomes: The government gives higher priority to the development of science and technology by effective allocation of public funds to research institutions and the implementation of a Comprehensive Connectivity Agenda to promote ICT development.</p> <p><u>Indicators:</u></p> <p>a. 40% of the budget is allocated according to findings of impact evaluations.</p> <p>b. Index of quality of scientific research institutions [GCR].</p> <p>c. Index of firm-level technology absorption [GCR].</p> <p>d. Index of university-industry research collaboration [GCR].</p> <p>e. Perceptions of government prioritization of ICTs improve with respect to the baseline [GCR].</p> <p>f. Increase in the number of local Internet sites per 10,000 inhabitants with respect to the baseline [GCR].</p>
IV. Formation of clusters				
Fragmentation of production chains. Little connectivity among public, private, and academic sectors.	<p>No mechanism for public-private co-operation.</p> <p>No private-sector leadership</p>	Create social capital in productive associations, to make participating businesses more competitive.	<p>IV.1 (i) Operating manual has been prepared; (ii) the fund has been set up, and an institution selected to manage it; (iii) training and dissemination forums have concluded; and (iv) the first project has begun.</p>	<p>IV.1 Outcome: More clusters have been created, and cooperation among them increases.</p> <p><u>Indicators:</u></p> <p>a. Perceptions of the degree of productive association development improve with respect to the baseline [GCR].</p> <p>b. Perceptions of the degree of cooperation among productive associations improve with respect to the baseline [GCR].</p>

SECTOR POLICY LETTER

Lima, 3 November 2003

Mr. Enrique V. Iglesias
President
Inter-American Development Bank

Dear Mr. Iglesias:

This letter confirms the commitment of the Government of President Alejandro Toledo to continue and to strengthen the competitiveness process in Peru, ranging from institutional factors to support for specific sector activities linked to this process.

To this effect, specific reforms will be initiated within the framework of the “Competitiveness Reform Program” with the Inter-American Development Bank (IDB). The goals of these reforms are to strengthen the institutional framework of the competitiveness process and effect reforms in such areas as dispute resolution, infrastructure, and finance, for the purpose of lowering business costs and raising productivity.

For a better understanding of the proposed actions, this document will describe:

- a. The economic program of the Peruvian Government, contained in the 2004-2006 Multiyear Macroeconomic Framework (*Marco Macroeconómico Multianual 2004-2006*) and backed by the International Monetary Fund.¹ This program covers fiscal, external, exchange, and monetary policies.
- b. The reforms implemented and proposed to improve Peru’s competitiveness. These can be grouped under four objectives: (i) the institutionalization of the competitiveness process, including the competitiveness strategy and the role of the National Competitiveness Council (CNC); (ii) the environment for private investment, taking into consideration macroeconomic stability and dispute resolution and bureaucratic procedures; (iii) business competitiveness, with particular attention to infrastructure, financing, and the quality of technology and human resources; and (iv) promotion of the creation of productive associations [clusters].

¹ As indicated in the standby arrangement, which covers through the first quarter of 2004.

I. Background

1. This operation represents the IDB's cooperation with the government, not merely to achieve isolated reforms in specific areas relating to business startup and reduction of certain bureaucratic procedures and costs, but to strengthen the link between the public and private sectors, building the trust and cooperation that will enable them to deal with common issues.
2. Development of the competitiveness process is an issue of major importance for the government, for which reason the administration of President Alejandro Toledo has implemented several initiatives to promote reforms in connection with this process, such as:
 - **National Accord** signed in July 2002, representing a 20-year commitment by the representatives of the country's political organizations and others, to confer the stability necessary for development of long-term policies to meet targets for growth and economic and social development in Peru.
 - **National Competitiveness Council (CNC)** created in April 2002, whose core mission is to develop and implement the National Competitiveness Plan to improve Peru's productive capacity.
 - **National Forum on Competitiveness** (*Foro Nacional de Competitividad*), held in February 2003 with IDB support, which brought together representatives from the executive and legislative branches, the private, academic/research, and labor sectors, and other civil society organizations, to obtain consensus-based proposals that would facilitate the preparation of Guidelines for a National Competitiveness Strategy for Peru (*Lineamientos para una Estrategia de Competitividad del Perú*).
3. With respect to reforms to promote private investment, measures such as the following have been adopted:
 - In August 2003, the Supreme Court of Justice approved the proposal of the Thematic Consultative Group for Civil Justice Reform of the Magistrates Commission for Judiciary Restructuring, and forwarded it to the Executive Council of the Judiciary for preparation of the studies required for the full bench to establish the commercial specialty and define its jurisdiction, and for the Executive Council of the Judiciary to subsequently set up and implement the jurisdictional bodies.
 - Adoption of Law 28032, published on 26 June 2003, aimed at eliminating bureaucratic barriers at any level of government that unduly affect the competitiveness of economic agents.

4. The following actions to support business competitiveness deserve special mention:

- Adoption of the National Port System Law (Law 27943), published on 1 March 2003, to regulate activities and services at terminals, infrastructure works and facilities located at maritime, river and lake ports, while fostering port development and competitiveness, and facilitating multimodal transportation, modernization of port infrastructure and development of the logistical chains involving ports.
- Formation of a commission to prepare a draft law governing guarantees, which would help resolve the main obstacles that economic agents have in putting up, registering, giving public notice of, and executing collateral (Ministerial Resolution 410-2002-EF/10 of 4 October 2002). This commission completed the draft of the Personal Property Security Act, which takes into account the comments and suggestions of the various stakeholders and includes international-practice-related actions. This draft law will be submitted to the Council of Ministers for consideration and subsequently presented to the national Congress.
- Adoption of the General Education Act (Law 28044) published on 29 June 2003, which sets out the general guidelines on education and the Peruvian Education System, the duties and responsibilities of the State and the rights and duties of people and society in their education functions. Within the scope of this law, provisions are established to ensure optimal education quality, among them the establishment of a National System of Evaluation and Accreditation, which includes upper-level technology and teaching institutes. Likewise, the Ministry of Labor and Job Creation (*Ministerio de Trabajo y Promoción del Empleo*) is developing a system for standardizing and certifying worker skills and labor training programs.
- Formation of a commission to collaborate in the design, formulation, execution, supervision and coordination of a national plan setting out institutional plans for scientific and technological research (Presidential Resolution 072-2003-CONCYTEC-P of 17 March 2003). The Executive Branch will also support, through the CNC, the creation of advisory groups, including one on technological innovation.

II. Macroeconomic policy and external financing framework

5. The core objective of the government's economic program is the fight against poverty and unemployment. This makes it imperative not only to revitalize the productive sector, but to maintain strong and sustained economic growth in the medium- and long-term, low inflation rates and a level of international reserves that will ensure the sustainability of external accounts.

6. In 2002, despite the crisis that impacted several countries in the region, Peru experienced strong macroeconomic performance. Exceeding expectations, growth in real Gross Domestic Product (GDP) was 5.2%, cumulative inflation in December reached 1.5%,² the consolidated public sector deficit was 2.2% of GDP, the current account deficit of the balance of payments was 2% and has held steady, strengthening the country's external position. Likewise, interest rates have fallen to the lowest levels in Peru's recent history and the exchange rate has remained stable, with only a 2.3% depreciation in 2002. The banking system was strengthened by rising national and foreign currency deposits and improvement in prudential indicators.
7. In the fiscal arena, the Government adopted tax reform measures in 2002. The administrative measures implemented in mid-2002 boosted revenue collection of the general sales tax (IGV), using large private enterprises as withholding agents, strengthening the oversight of taxpayer registries and procedures, broadening the supervisory authority of the Office of Tax Administration Oversight (SUNAT) and improving methods for monitoring taxpayer transactions with government agencies. Collection of the excise tax (ISC) on petroleum byproducts has also become more efficient; the tax base was broadened by eliminating certain third-category income tax deductions; the maximum income tax rate was raised from 27% to 30% for individuals, and a minimum advance tax payment for large taxpayers was established. These measures represented an annualized increase in revenue of 0.4% of GDP in 2002, and are expected to reach 0.8% of GDP in 2003.
8. In the short term, economic growth, low inflation and a strong external position are expected to continue. For 2003, real GDP is expected to grow between 4% and 5% with inflation around 2.5%. The balance of payments current account deficit is also expected to shrink slightly to below 2% of GDP, the consolidated public sector deficit from 2.2% of GDP in 2002 to 1.9% in 2003, and the accumulation of foreign reserves is expected to continue.³

² At the lower end of the 1.5% to 3.5% band that had been adopted as a monetary policy target.

³ As of 30 June 2003, net international reserves were US\$9.997 billion, equivalent to 15 months of imports.

9. Regarding fiscal policy, the Council of Ministers approved a set of measures in mid-June of this year, aimed at rationalizing public spending and tax exemptions, raising tax revenue and instituting a greater degree of equity in the procedures provided under [the public-sector pensions] Decree Law 20530 (“*Cédula Viva*”).⁴ The measures also cover austerity themes, such as lowering the remuneration of the president, ministers and senior public officials, and budget restructuring to benefit the education, health, interior, defense, and transportation and communications sectors.⁵
10. In late September, the national Congress delegated to the Executive Branch the power to enact tax legislation (Law 28079), including authority to amend the tax code to improve the assessment and oversight of tax liability, inspection, and injunctive measures; amend the Income Tax Act to expand its scope, change the deduction method, upgrade the determination of the assumed basis and valuation methods; and to rationalize sector tax exemptions that cause distortions in levels of business competitiveness and loss of efficiency in the system’s revenue collection activities.
11. The Government will also continue to work carefully on formulating the legal framework of the decentralization process, to ensure that it is implemented in an orderly manner, protecting public finances in the medium term. To that end, it has sent Congress draft legislation for a Fiscal Decentralization and Program Transfers Act, which supplements the law setting the main guidelines to which subsequent decentralization laws must adhere, as well as for a Regional Governments Act. This legislation seeks to establish the structure of the Peruvian tax system, taking into consideration the three levels of government (national, regional and local); regulate resource allocation to the regional governments, to ensure that the services and duties entrusted to them are carried out; establish tax incentives to boost tax revenue and make tax collection more efficient, along with incentives for sound management and efficient use of public funds; implement fiscal accountability rules that can be applied to the regional and local governments, to contribute to macroeconomic stability and sustainability of public finances; and order transfers, with an inspection and supervision process necessary to evaluate their impact on the system.
12. In general, for both the short- and medium-term, the government will maintain prudent economic policies in the 2003-2006 period, the crucial element of macroeconomic management being the sustainability of public finances through gradual reduction in the ratio of public debt to GDP, gradual reduction of the fiscal deficit, raising the tax ratio, rationalization of public spending and further strengthening of regular fiscal institutions.

⁴ This last measure required the approval of the national Congress.

⁵ As a result of these measures, tax revenue increases are expected on the order of some 402 million Peruvian new soles in 2003, and 2 billion in 2004.

13. **Foreign trade policy.** The government will continue to implement its trade policy strategy with a focus on reducing the average tariff rate and dispersion in a manner consistent with the country's international trade policy commitments. It will also enter into trade agreements that permit greater access to other markets. In particular, Peru will pursue negotiations for the gradual elimination of tariff barriers with its partners in the Andean Community of Nations (CAN). The medium-term objective is to help bring about the agreement on the Free Trade Area of the Americas (FTAA) become a reality in 2005.
14. As part of the efforts to set up the FTAA, Peru will continue to participate in negotiations on tariffs, nontariff measures, services, government procurement, investment, fair trade measures, intellectual property, competition policy and dispute resolution. Peru has given priority to the FTAA process, considering it convergent with the objectives of the World Trade Organization.
15. With respect to multilateral trade liberalization, Peru will also continue negotiations on pending issues relating to the recently signed free trade agreement with MERCOSUR, participate in meetings of the Asia-Pacific Economic Cooperation Forum (APEC), seek a free trade arrangement with the United States, and deepen bilateral agreements, such as those with Mexico and Chile, in the framework of the Latin American Integration Association (LAIA).
16. **Regulatory agencies.** The government undertakes to ensure a system of transparent and independent regulatory bodies, taking into account the appointment rules in effect that give stability and autonomy to their members.

III. Program-related structural reforms

A. Reforms on institutionalization of the competitiveness process

17. **Background.** As already noted, President Alejandro Toledo has called on Peru's main political forces and civil society organizations to commit to a National Accord that would benefit governance and development in the country. This accord will provide a basic framework for the exercise of political power, affording the necessary stability to formulate long-term policies aimed at attaining the targets of growth and social and economic development in Peru. Within the context of this accord, 29 long-term National Policies were adopted with four major objectives: democracy and the rule of law, social equity and justice, competitiveness, and lastly, achieving a more efficient, transparent and decentralized State.
18. **Prior initiatives.** Prior to the signing of the National Accord, at the 2001 Annual Conference of Executives, the private sector delivered a proposal to the Government to jointly draw up a National Competitiveness Plan, which would involve various key players in the government, the private sector and civil society. Later, with the signing of the National Accord, the conditions were created for the following institution-based prior initiatives to promote competitiveness:

- **Establishment of the National Competitiveness Council (CNC)**, as a result of recognizing the country's competitiveness as being one of the four major national objectives, and the private initiative that delivered a proposal to the Government for the joint preparation of a National Competitiveness Plan, producing a strategic public-private partnership. The CNC is set up as an ad hoc commission of the Office of the President of the Council of Ministers with government, private-sector and labor-sector participation. Among the CNC's key objectives are the design, promotion and ongoing monitoring of the National Competitiveness Strategy, interagency coordination, and the evaluation and proposal of measures and policies to raise the country's productivity and competitiveness.
 - **National Forum on Competitiveness**, held in February 2003 with IDB support, which brought together key representatives from the executive and legislative branches, private, academic, and labor sectors, and other civil society organizations. At this forum the documents prepared by nine participatory working groups on the following themes were presented and discussed: financial system and capital market, foreign trade and investment, education, competitiveness and regional development, institutional framework (intellectual property, transaction costs, legal processes and consistency of public policies), human resources and labor market, infrastructure (regulation, roads, ports and airports), technological innovation, business development and production chains. The forum succeeded in obtaining consensus-based proposals for preparation of Guidelines for a National Competitiveness Strategy for Peru to be approved by the CNC and later submitted to the Council of Ministers for consideration.
19. **Proposed institutional reforms.** The goal of these reforms is to strengthen the institutional framework for the competitiveness process and to develop and implement the National Competitiveness Strategy, aligning the policies and measures (public and private sectors) that will ensure the successful implementation of the National Competitiveness Plan to improve productivity and competitiveness.
20. The institutional machinery driving the competitiveness process in Peru would include four levels of public-private cooperation:
- The National Accord, the highest level of public-private dialogue;
 - The National Competitiveness Council (CNC), constituting the highest operative level of public-private cooperation;

- Consultative and/or technical groups set up by the CNC at its option, comprising interchangeably at the CNC's discretion members of the public, private and research-academia sectors, whose participation on this issue is important.⁶
 - Productive association plans at the local, regional or interregional levels.
21. **National Competitiveness Council.** The CNC represents the highest operative level of public-private cooperation on competitiveness. Its Board of Directors is the supreme decision-making body. Business sector representatives, the representative for small- and medium-sized enterprises and the labor representative will be persons with broad experience and knowledge of business and labor activities in the country, nominated and appointed by the private sector through its own institutional mechanisms. They will be appointed for a four-year term by supreme resolution, countersigned by the President of the Council of Ministers. They may only be removed for cause pursuant to a supreme resolution countersigned by the President of the Council of Ministers.
 22. The Board of Directors establishes the broad outline of the National Competitiveness Plan, designs the Competitiveness Strategy, approves action plans, adopts resolutions as necessary for their implementation and oversees their execution.
 23. The CNC also has a Technical Secretariat, which is the executive body of the CNC, under the direction of an executive director appointed by ministerial resolution of the President of the Council of Ministers at the recommendation of the Board of Directors of the National Competitiveness Council.
 24. The Technical Secretariat proposes to the Board of Directors the design for the National Competitiveness Plan and the regulatory measures necessary to achieve the objectives, tentative targets and policies. It also manages and supervises plan execution in coordination with key players; monitors plan activities for organizations involved in its execution, and assists in plan development in accordance with the outline established by the Board of Directors. The Technical Secretariat will also be in charge of providing technical, administrative and legal support to the Board of Directors for performance of its objectives, and representing it, within its areas of responsibility.
 25. The performance of the CNC will be evaluated one year after the signing of the loan contract for this program, in accordance with the criteria according to which it was created.

⁶ When the public sector is involved, this role will be assumed by officials on the level of deputy minister or director-general in the case of ministries, the executive director, in the case of decentralized government agencies, or, as appropriate, the highest authority directly under the regional governor or mayor, in the case of subnational governments.

26. To summarize, the proposal is intended to help the CNC operate more effectively, establishing:
- A process for selecting private-sector members through that sector's own institutional mechanisms that will guarantee their credibility, representativeness and independence;
 - Integration of the duties of the Executive Director and Technical Secretary, whose responsibility it is to propose to the CNC a design for the National Competitiveness Plan, manage and supervise the execution of the Plan, and monitor and promote the proposed activities;
 - The applicable functional modifications consistent with the space for public-private cooperation and dialogue and the CNC functions, including coordination of the execution of the National Competitiveness Plan for implementation of the National Competitiveness Strategy.
27. **Public-private consultative and/or technical groups.** The CNC may form technical and/or consultative groups to render advisory services for both the formulation of strategies and policies to promote competitiveness, and for coordination of the National Competitiveness Plan, which is the CNC's responsibility. Execution of the Competitiveness Strategy is the responsibility of the various ministries and bodies within the competence of the executive branch or of private trade unions in charge of the thematic areas.
28. The technical and/or consultative groups are spheres of public-private cooperation, preferably led by the deputy minister or highest corresponding public authority, and formed by members of the public, private and research-academia sectors, whose participation is relevant to the subject. These groups may be organized around themes of factor and market quality, and their main objective will be to study and propose strategies, policies and activities to continually improve the business environment, consistent with the National Competitiveness Strategy and the National Competitiveness Plan for its implementation, of which the competitiveness reform program is a component that should be implemented in the short-term.
29. Coordination of the groups will be within the CNC's operating framework, while the Ministry of Economy and Finance will coordinate program execution through its own institutional mechanisms.
30. Notwithstanding the fact that the executive branch cannot unilaterally commit itself to setting up certain consultative groups, it can indeed support, from within the CNC, the creation of groups on the following themes: technological innovation, information and communications technology (ICT), transportation, productive associations, intellectual property rights, competition and foreign trade.

B. Reforms to promote private investment

31. **Background.** The engine of the country's economic growth is domestic and foreign private investment. However, for this investment process to grow and be efficient, the State must provide a stable and predictable macroeconomic environment, with clear, standing ground rules in both the judicial and economic-policy spheres, including trade promotion and market liberalization. The structural reforms that foster an enabling environment for private investment involve not only the privatization of productive activities, but the provision of essential public goods for the institutional development and stability that will ensure competition among economic agents and, thus, generate productive growth.
32. Therefore, support will be initiated for certain judicial reforms and to push for improvements in dispute resolution and bureaucratic procedures, more effective and transparent methods, and lower business transaction costs.
33. **Prior initiatives.** To expand the use of dispute resolution and expedite the business startup process, the following prior actions were carried out:
 - **Judicial reforms** supporting studies for the creation of commercial courts to improve the business environment. The absence of specialized commercial courts in Peru has adversely impacted private business performance, causing legal uncertainty that dampens the business climate.

Improving the administration of justice in commercial cases through special courts contributes greatly to the stability of, and confidence in, contractual relationships, which are essential for business activity to be efficient and low-cost.
 - **Facilitate business startup and operation** through the elimination of bureaucratic barriers to make economic agents more competitive (Law 28032 of 26 July 2003). This instrument creates a substantial incentive for small businesses and microenterprises to enter the formal sector of economic activity, while reducing the time and uncertainty associated with bureaucratic requirements for business startup and operation. It also cuts the transaction costs of businesses already in the formal sector, making them more competitive.
34. **Policy reforms proposed for the sector program.** Reforms to better promote private investment seek to consolidate the prior actions described above, particularly in the following areas:
 - **Judicial reforms** for the creation of self-sustaining commercial courts, as undertaken by the Supreme Court, in the districts of Lima, Callao, Cono Norte and provincial towns. The Supreme Court of Justice is also expected to approve and set up at least seven self-sustaining commercial courts in the district of Lima, as well as develop a training plan for judges specializing in the field.

- **Improve arbitration procedures and the extrajudicial dispute resolution system** as an alternative to court proceedings, which may be attractive to businesses. The goal of this reform is to streamline and rationalize the costs associated with these procedures to incentivize small- and medium-sized enterprises in particular to use this method instead of the courts. The reforms call for the creation of an arbitration center information system that allows access to information such as rates and statistics on the kinds of cases heard and decided. The mandatory mediation system and its impact on trade-related cases will be analyzed for purposes of implementing the applicable measures for improvement, if necessary.
- **Streamlining of bureaucratic procedures** through the creation and development of an information system for monitoring bureaucratic procedures (SIMTA) in government agencies, which will monitor business filings, their status, and the party responsible; develop a unified registry of functions and procedures, and reduce the time and costs of starting a business. Finally, this system will serve as the institutional basis for developing the e-government tools for people and businesses to use. The system will operate in national government agencies involved with business procedures, such as permits, authorizations and payment processing, and incorporate an efficiency measuring mechanism called “tramitómetro” that will show the status of the procedure, time and person in charge, and a unified registry of functions and procedures that help lay the institutional foundation for the creation of e-government tools for people and businesses to use.

C. **Business competitiveness reforms**

35. **Background and prior initiatives.** To increase business competitiveness, measures have been taken in the areas of infrastructure, financing, labor training and technology, such as:
- **Infrastructure.** As mentioned above, the National Port System Law was published in March of this year, establishing the framework for increasing port competitiveness.
 - **Financing.** One of the government’s concerns is designing and implementing mechanisms so that a greater number of microenterprises and small- and medium-sized enterprises may have access to the financial system at the lowest possible cost. For that reason, a commission was formed to draft legislation that would help overcome the main obstacles of economic agents to put up, register, give public notice of, and execute personal property as security.
 - **Labor training.** Given the importance of supporting the training of skilled technicians and professionals to meet the needs of industry, not only from the viewpoint of employment, but from a productivity standpoint, actions are being carried out to develop standardization and accreditation procedures, as well as specialized programs to guarantee effective technical/professional competency.

- **Technology.** The government believes one of the priority issues for improving competitiveness is to promote technological innovation, for which reason commissions have been set up to prepare institutional plans for scientific and technological research and to develop an information society in Peru, taking into account international best practices.
36. **Institutional reforms proposal for the sector program.** In view of the importance of the areas described above, actions will be taken to enable reforms or their consolidation in those areas:

- **Infrastructure.** For purposes of clearly setting out the objectives and targets of the State with respect to infrastructure, the policies of the highway and urban, maritime and air transportation sectors will be prepared and published, and priority measures will be taken in those sectors to ensure private investment participation, as well as the clear allocation of sector competencies and definition of financing mechanisms. To spell out the provisions contained in the National Port System Law, the government will issue the pertinent regulations governing economic liability (tariff and access regulation). In addition, measures will be taken and coordination efforts will be made as necessary to expedite the granting of concessions for two ports.
- **Financing.** To lessen financial system uncertainty and hence, financial cost, the Superintendency of Banks and Insurance (SBS) will conduct a process of standardizing financial statements of businesses that report to all financial system institutions it oversees, which will be included in the database of the SBS risk center. Moreover, the draft Personal Property Security Act, laying the groundwork for a modern, dynamic system of guarantees on personal property, will soon be sent to the national Congress.

Public information campaigns will be carried out to explain the benefits of the positive information reported to the risk centers, as well as the benefits and requirements of the new loan security system.

The government undertakes to adopt the following measures, among others:

- Maintain the State's subsidiary role in loan markets and other financial sector operations;
- Ensure an effective legal and regulatory framework, to encourage the development of private financial intermediaries;
- Deliver financial services through sound private intermediaries;
- Recognize the benefits of allocating resources based on market prices; and
- Maintain COFIDE exclusively as a second-tier bank. For better financial market penetration, the government will adopt, among other actions,

initiatives to attract private financial institutions to rural areas (including expansion of risk center services to those areas).

- **Labor training.** Systems for evaluation and accreditation of upper-level technological and teaching institutes will be established, as well as a pilot system for work competencies certification. The development and upgrade of labor training programs for employees and managers of microenterprises, small businesses and young people will continue.
- **Technology.** A system of monitoring and evaluation of publicly-funded research institutions will be established, to ensure the efficient allocation and expenditure of resources earmarked for technology, and the pertinent actions will be carried out to ensure the issuance of a Plan for Development of an Information Society, which will include the opinion of civil society and the private sector. As noted, the Executive Branch will also support, from within the CNC, the creation of a consultative group on technological innovation.

D. Productive associations

37. **Background and prior initiatives.** Programs in support of productive associations have been executed in several countries as effective mechanisms for creating jobs and increasing production, competitiveness and the level of wealth of the population. The general idea of these programs is to create collective benefits through associative experiences with the building of enterprise networks and production chains that make better use of local capacities, maximizing value added. Businesses working together along a production chain adds greater value, which is reflected in the creation of jobs and investments.
38. The effectiveness of clustering is greater than that of each business in isolation, owing to the interaction of each one with the others, that is to say, its action generates benefits for itself as well as for the other businesses in the cluster. Reasons for this collective benefit include:
 - Solid interaction among the various enterprises (suppliers, producers, users, services, etc.) facilitates and brings about a greater learning experience, and thus, greater efficiency.
 - Increased clustering of enterprises in the region attracts more customers, thus generating a bigger market.
 - Heavy competition generated by this enterprise clustering leads to more specialization and division of work, creating greater competitiveness.
 - Transaction costs are reduced since the economic agents interact continually, creating a relationship of trust and know-how.

39. There are currently numerous private and public institutions in Peru interested in operating in areas that have a productive association theme, among them nongovernmental organizations (NGOs), the Ministry of Production, the Ministry of Foreign Trade and Tourism, PROMPYME and PROMPEX. However, the initiatives by these institutions should be integrated and made complementary.
40. **Institutional reforms proposed for the sector program.** For the required integration and complementarity, the Government will formulate a plan of action to promote productive associations, which will help make Peru's economy more competitive through close cooperation among businesses from relatively simple arrangements such as productive associations, to other, more complex systems such as clusters.
41. The plan of action will include a coordinated institutional design and the creation of a fund to support linkages among businesses, which will initially finance productive association projects with a view to capturing funds from alternative sources so that, with time, more projects can be financed. Technical capacity in the promotion of associative systems must also be developed, and the program benefits publicized.

IV. Conclusion

42. The foregoing attests that the Peruvian government is taking meaningful action to integrate the sector strategies on competitiveness with strong public-private support, and to promote a sustained competitiveness process in the country.
43. To this effect, we believe that both the institutional strengthening of the process and the implementation of reforms in the justice, infrastructure, finance, labor training, technology and other sectors along with intersectoral reforms such as reducing the red-tape involved in starting a business, are essential for Peru to become a solidly competitive country.
44. The Government undertakes to continue moving forward in these areas, for which it must continue to rely on the support of the Inter-American Development Bank in the above-mentioned areas.

In view of the foregoing, the Government of Peru hereby requests approval of the Competitiveness Reform Program.

Sincerely,

Jaime Quijandría Salmón
Minister of Economy and Finance

**PERU. COMPETITIVENESS REFORM PROGRAM
(PE-0239)**

BREAKDOWN OF SUPPORT FUND CONTRIBUTIONS BY PROGRAM ACTIVITY

ACTIVITIES	ESTIMATED COST (IN THOUSANDS OF US\$)
TOTAL	5,000
I. INSTITUTIONALIZATION OF THE COMPETITIVENESS PROCESS: CNC AND THE COMPETITIVENESS STRATEGY	520
1. CNC – Institutional structure: Function of the Technical Secretariat. Support to the Consultative Groups. CNC evaluation study	490
2. National Competitiveness Strategy: Monitoring and evaluation of the implementation of the National Competitiveness Strategy.	30
II. ENVIRONMENT FOR PRIVATE INVESTMENT	1,929
A. Macroeconomic stability	No technical support for this item
B. Conflict resolution and bureaucratic procedures	1,929
1. Creation of commercial courts: Economic impact evaluation of commercial courts. Definition of court case load standards. Oversight of magistrates. Establish models for development and supervision of court functions. Systematization of case law. Customer service training. Support staff workshops. E-mail notification. Reduction in number of cases set aside.	1042
2. Improvements in the extrajudicial system: Mediation impact; training-mediation. Alternative dispute resolution mechanisms. Implementation of web page. Decentralized events – arbitration (including four conferences).	154
3. Bureaucratic procedures: Project coordination. Overall analysis. System design. Evaluation of available tools. Development and maintenance of portal. System implementation and quality control. RUPA procedure analysis. Equipment for labor ministry (MTPE) and headquarters.	733

ACTIVITIES	ESTIMATED COST (IN THOUSANDS OF US\$)
III. ENTERPRISE COMPETITIVENESS	743
C. Infrastructure (roads, ports and airports) and regulation of public services	165
1. Infrastructure policy: Formulation of and consensus-building for policies for the highway and urban, maritime and air transportation sectors.	60
2. Regulations implementing the National Port System Law: Support the creation of the institutional framework of the port sector and port concessions.	105
D. Financing	296
1. Risk centers: Informational campaigns on the importance of maintaining a good credit history	16
2. Effectiveness of the Personal Property Security Act: Implementing regulations. System design, development and implementation. System distribution and operability.	280¹
E. Labor training	132
1. Quality of occupational training institutions and certification of worker skills: System of evaluation and accreditation of occupational training institutes (including strengthening of accreditation system and the systematization and improvement of the evaluation pilot process of 20 occupational training institutions). Validation of worker skills guidelines and design and validation of instruments for evaluating prioritized guidelines.	94
2. Labor training programs targeting specific groups: Development and implementation of registry of training providers. Evaluation of training and financing mechanisms for a new worker training incentive system.	38

¹ Loan 1196/OC-PE, currently in execution, includes up to US\$100 million in financing for this activity.

ACTIVITIES	ESTIMATED COST (IN THOUSANDS OF US\$)
F. Technology	150
1. Impact evaluation of technological research institutions: Implementation of competitive funding system for technological institutes.	150
2. Information technology and communications (ITC): Preparation, approval and issuance of the Plan for Development of an Information Society.	Private funds
IV. PRODUCTIVE ASSOCIATIONS	951
1. Productive associations (clusters): Technical coordination group. Hiring of technical team for the coordination group. Events (including training courses and forums). Fund implementation.	951
V. FUND ADMINISTRATION AND TECHNICAL SUPPORT SUPERVISION (including compilation of data on measures of program effectiveness)	700
VI. OTHER ACTIVITIES AND CONTINGENT EXPENSES	157